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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1961

No. 224

THE HANOVER BANK, EXECUTOR, ET AL.,
PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 11, 1961
CERTIORARI GRANTED OCTOBER 9, 1961

SUPREME COURT OF THE UNITED STATES

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[fol. A]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 68443

ESTATE OF A. GOURIELLI, Deceased, THE HANOVER BANK, Executor, and HELENA GOURIELLI, surviving wife, c/o David A. Berlin, 1775 Broadway, New York 19, New York, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances for Petitioner:

David Alter, Esq., 32 East 57th St., New York 22, New York; Hubert Thurschwell, Esq., 32 E. 57th St., New York, N.Y.

ent. 5-20-59

DOCKET ENTRIES

Date	Filings and Proceedings	Action	Served
June 26, 1957	Petition Filed: Fee Paid 6/26/57		July 2, 1957
Aug. 27, 1957	Answer by resp. filed		Sept. 4, 1957
Aug. 27, 1957	Request by resp. for trial at New York, N.Y.	Granted 9/3/57	
Feb. 4, 1959	Notice of Trial at New York, N.Y. May 18, 1959		Feb. 4, 1959
Apr. 7, 1959	Motion by petr. for order to stipulate or in the alternative to take deposition upon written interrogatories, written interrogatories attached	Denied 4-22-59	
Apr. 8, 1959	Notice of hearing April 22, 1959, Wash. D. C. on petrs' motion		Apr. 8, 1959

Date	Filings and Proceedings	Action	Served
Apr. 22, 1959	Hearing on petr. motion for order to stipulate or to take deposition.		
Apr. 22, 1959	Order, that petr. motion is Denied.		May 1, 1959
Apr. 23, 1959	Transcript of proceedings of April 22, 1959.		
May 20, 1959	Trial at New York by Judge Murdock. Resp. motion to quash subpoena, requiring production of certain documents —Denied. Appearance of Hubert Thurschwell, Esq., and Stip. of Facts. filed. Resp. motion served. Proof of service of subpoena filed. Briefs due July 20, 1959 — Replies due Aug. 19, 1959. Under Submission		
[fol. B]			
May 27, 1959	Order, amending caption entered.		Jun. 2, 1959
June 9, 1959	Transcript of proceedings of May 20, 1959.		
July 8, 1959	Motion by resp. for extension of time to August 6, 1959 to file Brief	Granted 7-10-59	July 13, 1959
Aug. 3, 1959	Motion by petr. to correct transcript, "No obj. by resp."	Granted 8-3-59	Aug. 4, 1959
Aug. 5, 1959	Motion by petr. for extension of time to Sept. 18, 1959 to file Brief "No obj. by resp."	Granted to 9/2/59 8-6-59	Aug. 7, 1959

Date	Filings and Proceedings	Action	Served
Sept. 2, 1959	Orig. Brief filed by resp.		Sept. 3, 1959
Sept. 3, 1959	Orig. Brief filed by petr.		Sept. 3, 1959
Oct. 2, 1959	Reply Brief filed by petr.		Oct. 22, 1959
Nov. 30, 1959	Findings of Fact and Opinion filed, J. Murdock. Decision for respondent.		Nov. 30, 1959
Dec. 30, 1959	Motion by petr. for Review by Full Court	Denied 12-31-59	Jan. 4, 1960
Dec. 31, 1959	Motion by petr to modify findings of fact and for additional findings of fact	Denied 12-31-59	Jan. 4, 1960
Dec. 30, 1959	Motion by petr for reconsideration.	Denied 12-31-59	Jan. 4, 1960
Dec. 31, 1959	Decision entered, Judge Murdock.		Jan. 4, 1960
	APPELLATE PROCEEDINGS		
Mar. 7, 1960	Motion to fix amount of bond filed.		
Mar. 8, 1960	Order fixing amount of bond at $21,000.00.		
Mar. 30, 1960	Bond in the amount of $21,000.00 approved and filed.		
Mar. 30, 1960	Petition for Review by U.S. C.A. 2nd Cir. filed by petrs.		Mar. 30, 1960
Mar. 30, 1960	Proof of Service of pet. for rev. filed.		

[fol. 1]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 68443

ESTATE OF A. GOURIELLI, Deceased, and HELENA GOURIELLI, Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Room 5050,
Grand Central Terminal Building,
70 East 45th Street,
New York, New York.

Transcript of Testimony—Wednesday, May 20, 1959

(Met, pursuant to notice, at 10:00 o'clock a. m.)

Before: Hon. J. Edgar Murdock, Judge.

APPEARANCES:

David Alter, Esq., and Hubert Thurschwell, Esq., 32 East 57th Street, New York, New York, appearing on behalf of Petitioner.

John J. Madden, Esq., and William F. Chapman, Esq., Internal Revenue Service, 90 Church Street, New York 7, New York, appearing for Respondent.

[fol. 3] Proceedings

The Clerk: Docket 68443, Estate of A. Gourielli.
Counsel will please state their appearances.
Mr. Alter: David Alter appearing for petitioners.
Mr. Madden: John J. Madden and William F. Chapman for the respondent.

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* Corrections made per Motion to correct Transcript filed 8-3-59.

The Clerk: There is another entry for the petitioner?
Mr. Alter: Yes. Hubert Thurschwell.
The Court: For your information, I have read the pleadings in the case and there is a deficiency in income determined in the amount of $14,000 for 1953, and the item in dispute is $18,000 which the Commissioner disallowed as amortization premium on bonds and he says this deduction, his explanation is that this deduction claimed on your return for bond premium amortization has been disallowed to the extent shown inasmuch as it has not been substantiated as allowable under the provision of the Internal Revenue Code.

As I understand it, these bonds were purchased as a premium. They had a call provision within 30 days and there were other call provisions and one of the calls was one hundred five and a half or something like that, and the other one was one hundred two and a half or something like that, and the Commissioner allowed amortization to the higher call amount but not to the lower and the difference between the two, as I understand it, is the dispute. Is that right?
[fol. 4] Mr. Alter: That is correct, Your Honor.
The Court: You may proceed.

Opening Statement on Behalf of Petitioner

By Mr. Alter

Mr. Alter: As Your Honor stated, the only question involved in this proceeding is whether the petitioners correctly determined the amount of amortizable bond premium on Appalachian Power Compay bonds with respect to the lower redemption price of 102⅜. The applicable statute is 125 of the Internal Revenue Code of 1939. Under this Section of the Code, 125(b)(3) the method of determination of the amount of amortization is to be made (a) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond if such method is reasonable; (b) in all other cases in accordance with regulations prescribing reasonable methods of amortizing bond premium prescribed by the Commissioner with the approval of the Secretary.

It is our contention that the method of amortization used by the petitioners is that prescribed by the regulations and/or as well it is the method regularly employed by the petitioners, and that that method is reasonable.

On the question of reasonableness, the Commissioner has ruled in 1952, in ruling letters which were unpublished, in private ruling letters that amortization could be taken on these same bonds with reference to the special redemption premium. These ruling letters were not addressed to [fol. 5] the petitioners in this case. They are pertinent to this case, however, in that they bear directly upon the question whether amortization to this special redemption price is reasonable. It indicates that the Commissioner's office in 1952 and 1953, down through '56, was of the opinion in his Tax Rulings Division that it was a reasonable method.

We have subpoenaed the Commissioner to furnish copies of the rulings without disclosing the names of the taxpayers to whom they were addressed, and we trust they will be offered in evidence this morning pursuant to that subpoena.

In addition to that, we will have the taxpayer's representative testify as to the transactions involved and the method of claiming the amortization deduction.

We also intend to have an expert witness testify as to the custom in corporation finance in regard to call provisions for bonds prior to maturity and the significance of general and special redemption premiums in such call provisions.

The Court: All right.

Do you want to make a statement before we begin?

Mr. Madden: No, Your Honor, I just want to discuss one feature of Mr. Alter's statement, that is with respect to these rulings in connection with which a subpoena was served.

The Court: Why don't we take it up when we get to it?

Mr. Madden: All right.

[fol. 6] OFFER IN EVIDENCE

The Court: Do you have a stipulation you want to offer?

Mr. Madden: Yes.

The Court: The stipulation may be received.

Mr. Madden: Respondent's position is based on Revenue Ruling 56-398 which appears in Cumulative Bulletin 1956-2, page 984.

The Court: You may proceed. The stipulation, as I understand it, covers the mechanical financial details of what happened, is that right?

Mr. Alter: Yes, Your Honor.

The Court: You are not going to testify about that at all?

Mr. Alter: No.

The Clerk: Exhibits 1-A through 4-D are attached to the stipulation.

(Whereupon, the Stipulation and Joint Exhibits 1-A through 4-D were received in evidence.)

Mr. Madden: Yes, that is right.

The Court: To make sure that I understand what did happen, did the petitioner buy these at a premium of about or exactly seventeen and a half?

Mr. Alter: The premium was about fifteen points, the difference between the—

The Court: Could you give me the exact figure at which [fol. 7] he bought them, just for my own information so I will keep up with you? I don't mean the amount but the premium.

Mr. Alter: Right.

The Court: Percentage-wise.

Is it all one is is there more than one purchase?

Mr. Madden: Three separate purchases.

The Court: Three. They weren't all the same. What is the difference between the two premiums you say?

Mr. Alter: About three points on a hundred.

The Court: Between what he purchased them for and the amount that you claimed was the amortization low point, in other words, you are taking—

Mr. Alter: We claimed about a fifteen point deduction.

The Court: A fifteen point spread between what you purchased them at and the figure you want to amortize them to?

Mr. Alter: That is right, and a twelve point spread between the purchase price and the Government's figure.

The Court: Yes. Yes. Go ahead.

Mr. Alter: I would like to call Mr. David Berlin to the stand, please.

David A. Berlin was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

[fol. 8] The Clerk: Please state your name and address for the record.

The Witness: David A. Berlin, 1775 Broadway, New York City.

Direct examination.

By Mr. Alter:

Q. What is your profession, Mr. Berlin?

A. Accountant.

Q. How long have you been practicing accountancy?

A. Forty-seven years.

Q. Do you now represent the petitioner Helena Gourielli in this action?

A. Yes, for the past 33 years, I guess.

Q. Then you were her representative in the year 1953?

A. Oh, yes.

Q. Are you familiar with the transaction in which petitioner purchased Appalachian Electric Power Company bonds in that year?

A. Quite.

Q. Did you act for and represent petitioner in that transaction?

A. What do you mean, did I act?

Q. Did you give instructions for the purchase?

A. Yes.

Q. Specifically what instructions did you give to the [fol. 9] broker with respect to the purchase of these bonds?

A. At the time the bonds were ordered, I instructed him to buy at the best price.

Q. And the purchase was made accordingly, you were so advised?

A. Yes.

Q. Did you thereafter act on petitioner's behalf in selling the bonds?

A. Yes.

Q. Did you instruct the broker to make the sale?

A. At the best price.

Q. What basis?

A. The best price.

Q. You received advice that this was done?

A. That is right.

Q. Have you prepared the petitioner's tax returns in all of the years of your representation of petitioner?

A. I believe so.

Q. Did you prepare the petitioner's tax return in 1953?

A. Right.

Q. Was a deduction for bond premium amortization claimed on this return?

A. Yes.

Q. To the best of your knowledge, was this the first time that a deduction for bond premium amortization was [fol. 10] claimed by petitioners on any returns filed by petitioners?

A. I believe so.

Mr. Madden: Objection. It is entirely irrelevant.

The Court: For what it is worth, it may stand.

Mr. Alter: The relevance of that, Your Honor, the statute and the regulations under it state that the method regularly employed by the petitioner—

The Court: It is in, you don't have to explain it to me.

By Mr. Alter:

Q. How was the amount of bond premium determined, Mr. Berlin?

A. It was the excess of the cost of the bond over the earliest call price, the special call price.

Q. On what basis did you use this method of amortization?

A. Well, I based my opinion on the regulations under the then prevailing sections of the Code pertaining to amortization. I think you mentioned it awhile ago, 125.

Mr. Alter: That is all.

The Court: He is referring there to the Code, isn't he?

Mr. Alter: The regulations under Section 125 of the Internal Revenue Code of 1939. That is what he was referring to.

The Court: All right.

[fol. 11] Cross examination.

By Mr. Madden:

Q. You advised the petitioners in this proceeding to buy these particular bonds, is that correct?

A. The broker advised her and I approved the purchase of the bonds.

Q. Well, it was at your suggestion, was it not, that petitioners contacted the broker for the purpose of making a bond purchase, isn't it?

A. I don't quite follow you.

Q. You were the tax adviser to the petitioners during this period of time, isn't that right?

A. That is right.

Q. Isn't it true that you advised the petitioners to contact their broker for the purpose of securing these bonds?

A. I contacted the broker. I had full power.

Q. You did that after determining that there was a substantial short term capital loss which the petitioners had suffered, isn't that correct?

A. I knew that there was a loss at the time, yes.

Q. In determining what bonds should be purchased, you looked around for so-called tax gimmick bonds, did you not?

Mr. Alter: I object, Your Honor.

The Court: Tax what bonds?

Mr. Madden: Gimmick.

[fol. 12] The Court: Tax?

Mr. Madden: Tax gimmick bonds.

The Court: I thought this case involved Appalachian bonds.

Mr. Alter: I know of no bonds called tax gimmick bonds.

By Mr. Madden:

Q. You have been a certified public accountant for many years, is that correct?

A. Yes.

Q. I think it could be taken for granted that under the circumstances they bought with the idea in mind that they would get this deduction for the amortization of bonds.

The Court: Unless they are stupid we would have to assume that that is the fact?

A. I didn't look around. The broker picked up these bonds and told the lady that it would be an excellent investment for her.

Q. In other words, they would suit the purpose of getting a short term capital gain offset?

A. I realized that would have occurred and she sold the bonds during the period but I also realized it would be an excellent hedge in the event the bonds went down materially.

Q. You also knew by using the special redemption price for the purpose of determining the amortizable bond premium that there would be a substantial deduction involved?

[fol. 13] A. To the amount of the bond amortized, naturally.

Q. I believe you stated you determined the rate of bond premium based upon the statute and regulations, is that correct?

A. That is right.

Q. Did you ever read the indenture and mortgage under which the bonds were issued?

A. Not intensively. I depended primarily upon the opinion of the broker.

Q. Were you aware of the conditions under which the special redemption price was applicable?

A. Not at the moment. I did at the time we went into it. I thought it was outside my realm.

Q. Well, I will ask you, Mr. Berlin, to take a look at Exhibit 3-C. It is one of the exhibits attached to the stipulation of facts. Your attention is directed especially to page 31, in the last paragraph of that.

Mr. Alter: May it please Your Honor—

The Court: There is no question pending.

Mr. Alter: I understand. I would like to point out, however, that there is a legal document, a corporate indenture which exceeds anything discussed on direct examination, and if there is any intention to ask Mr. Berlin to construe this document, I think it would be—

The Court: Let us wait until we find out what the ques-
[fol. 14] tion is. He has asked him to look at it. He can't answer that question. You don't want to have him spend the morning reading it.

Mr. Madden: It is only one paragraph.

The Witness: I got the gist of it.

By Mr. Madden:

Q. You will recall that the special redemption price is applicable only if bonds are redeemed by the use of application of cash, by the use of proceeds of released property, proceeds of insurance, is that correct?

A. That is the way it reads.

Mr. Alter: I object.

The Court: It is in evidence.

Mr. Alter: It is in evidence. I object to Mr. Berlin's attempt to construe it.

The Court: He is undoubtedly leading up to some question. I have been doing this for years. He is not going to fool me at all.

The Witness: I don't intend to.

The Court: I don't mean you, I mean Mr. Madden. You answer the questions.

By Mr. Madden:

Q. Were you aware of that provision?

A. I believe I read it at one time.

Q. Did you consider that provision at the time you ad-
[fol. 15] vised the petitioners with respect to the amortizable bond premium?

A. It may have been part of my consideration. I don't remember. It is over six years ago.

Q. Then it is your testimony to the Court then you do not recall examining the particular provision with respect to the method at which the special redemption price—

A. No.

The Court: Don't answer until he finishes the question because the reporter can't take two people at the same time.

By Mr. Madden:

Q. Your testimony is that you don't recall whether you considered the special provision of the indenture applicable to the special redemption price when you advised the petitioners as to the amount of the amortizable bond premium?

A. I was aware of it, yes. I don't know whether I got it here or from other sources.

Q. Did you determine how much cash Appalachian Power Company had available and how much proceeds of insurance they had available?

A. I don't think I did.

Q. You did not do that?

A. I don't think so.

Mr. Madden: That is all.

[fol. 16] Redirect examination.

By Mr. Alter:

Q. Did you know about the Commissioner's unpublished ruling at the time the transaction was entered into?

A. Yes, I believe there were two rulings.

Mr. Madden: Objection.

The Court: He may answer.

Mr. Alter: I am sorry, will you repeat your answer?

The Court: He said—

The Witness: I believe there were two rulings.

By Mr. Alter:

Q. What was the source of your information about these rulings?

A. Well, I read them, is that what you mean by the source?

Q. Where did you obtain them?

A. I think the broker got them for me because when I went into the advisability of suggesting the purchase of these bonds, I asked various questions, and he obtained for me, I believe, these rulings, copies of them, I don't remember which.

Mr. Alter: No further questions.

Mr. Madden: No further questions.

The Court: The witness is excused.

(Witness excused.)

[fol. 17] Mr. Alter: I call upon the respondent to furnish the unpublished rulings requested by subpoena which was served on May 5th, 1959.

MOTION TO QUASH AND DENIAL THEREOF

Mr. Madden: In this connection, the respondent has a motion to quash the subpoena. If you would like to hear me on it, I would like to be heard on the motion.

Mr. Alter: May I have a copy of the motion?

The Court: I am not sure I understand it too well, but petitioner has in its file here a motion to take a deposition. In connection with that, he has attached two documents which he says is what he wants. I assume they are the same documents he is talking about now.

Mr. Madden: Yes, as I understand it, the subpoena was broader than the two documents referred to.

The Court: All you are talking about now is that you

want these two documents?

Mr. Alter: Yes, Your Honor.

The Court: Do I understand that a subpoena has been issued for them?

Mr. Alter: Yes, Your Honor.

The Court: Is it conceded that these are correct copies of the documents that are attached to this motion for a deposition? These don't have dates on them. What is the alleged date?

Mr. Alter: December 2, 1952 on the first.

[fol. 18] The Court: And the second one is what?

Mr. Alter: March, 1956. I will have the date in a moment, Your Honor. I believe it was March 1st, 1956.

The Court: Well, it would seem to me, Mr. Madden—

Mr. Alter: March 22, 1956.

The Court: There doesn't seem to be any misunderstanding about what documents we are talking about here and assuming that these are the documents, the witness said he had some familiarity with at the time of the purchase of the bonds. It seems to me that they could properly be admitted in evidence for what they might be worth. I don't think they are necessarily binding upon the Commissioner. I am not deciding that point.

Mr. Madden: I do not believe that you should take the position in this court that the respondent is bound to produce the records in this court. Insofar as what the petitioners represent reliance upon, he might have relied upon anything. I will not admit for the purpose of this argument that these are exact copies of the rulings. I want to take the position that the rulings are totally irrelevant to any matter involved in this proceeding. We are not dealing with an administrative procedures act where a certain procedure has to be gone through by the agency that removes. We have a de novo trial—

The Court: It seems to me they would be or might be [fol. 19] admissible. Rather than err by striking them out, I would rather let them in. The point is this: The witness has testified in the purchase of the bonds, acting on behalf of the taxpayer, he was made aware of something by the broker. If there is any doubt about the substance of what he saw or not, that would be a different story. If these

documents that we are talking about are in substance what he was shown by the broker and was told that such rulings had been made and actually they were made and had been made, they might have some possible bearing upon the question in that the Commissioner is now taking a position inconsistent now with the time the purchase was made.

Rather than rule them out, I will rule them in. I deny your motion to quash.

Mr. Madden: The motion to quash is denied?

The Court: Right.

Mr. Madden: I respectfully refuse to produce the rulings from our files on the grounds that these rulings are confidential.

The Court: I suppose that is your privilege to refuse to produce them, so we will proceed from there.

Mr. Alter: Copies of these ruling letters were furnished by respondent in answer to interrogatories propounded by plaintiff in a proceeding of the District Court for the Middle District of Tennessee. He has furnished copies of these [fol. 20] rulings. Apparently, in that case, he takes the position they were not privileged. In this case he takes the position he is privileged not to disclose them. As to privilege, there is authority to the effect that the privilege does not exist.

The Court: I am not concerned about that. He is not going to produce them. What are you going to do?

Mr. Alter: If Your Honor wishes, I will furnish them. I have a certified copy of the findings of fact and the conclusions of law in the Parnel case in the Middle District of Tennessee. The findings of fact incorporate the body of the ruling letters, copies of which are attached to my motion paper. These were the ruling letters produced in that case in response to the interrogatories. I have a certified copy of the interrogatories and the Commissioner's answer in that case all certified by the Clerk of the Court of Appeals in the Sixth Circuit, where the matter is now pending.

The Court: You want to offer these in lieu of the documents that the Commissioner refuses to supply, right? Is that what you want to do? What are you going to do with them?

Mr. Alter: I will offer them in lieu of the documents which the Commissioner refuses to supply, as one exhibit.

Mr. Madden: May I see them, Your Honor?

The Court: You are only offering them to show the two documents you were talking about?

[fol. 21] Mr. Alter: Yes. I don't offer them to satisfy the Commissioner's obligation to produce. I offer them to have them in evidence in this case.

The Court: That is what I thought you were doing.

You are going to ask this witness before he goes whether he saw these things he is talking about because he mentioned something. Now you are putting something else in. Let us be sure these are the ones he was talking about.

Mr. Alter: Thank you, Your Honor.

Mr. Madden: These are offered for the purpose of showing what these rulings of the Commissioner were.

The Court: That is right.

Mr. Madden: I do not believe that it is proper or possible to do it in this fashion.

The Court: You mean they are not the best evidence?

Mr. Madden: They are not the best evidence.

Mr. Alter: The best evidence has been denied us by you. They are now the best evidence available.

Mr. Madden: I do not claim, Your Honor, to rely upon that. I do question whether or not these have been properly identified.

The Court: If he offers them and doesn't prove them, that is something else, but they are admissible, are they not?

Mr. Madden: Well, it is quite possible they are admissible as records of the court since they have been sealed with [fol. 22] the seal of the court and so identified, but whether or not they are admissible for the purpose of proving rulings of the Internal Revenue, that is another matter. That is the reason they are offered. You understand we take the position these rulings are irrelevant.

The Court: I am not ruling on how material they are or not. I am only admitting them. They may be admitted.

The Clerk: Exhibit 5.

(Whereupon the document was marked Petitioner's Exhibit 5 and received in evidence.)

Mr. Madden: I might point out to Your Honor, if I might, that the dates on those rulings are different from the dates

petitioner's counsel gave a little while ago with respect to the rulings which are attached to the motion to take a deposition.

The Court: Do you want to give me the correct date?

Mr. Alter: I am concerned with December 2, 1952 and March 22, 1956.

I would like to recall Mr. Berlin to the stand.

DAVID A. BERLIN was recalled as a witness on behalf of the Petitioner and, having been previously sworn, testified as follows:

Direct examination.

By Mr. Alter:

Q. I show you a copy of a letter dated December 2, 1952, [fol. 23] signed by Norman A. Sugarman, Assistant Commissioner, by Mr. Swartz, Head of the Technical Ruling Division, which is contained in petitioner's Exhibit 5. Have you ever seen a copy of this letter before?

A. I believe so. To all intents, the contents appear to be identical with what I saw. Whether this is the exact copy or not, I couldn't say.

Q. I will read you the last paragraph from this letter—

The Court: Can't he read it?

The Witness: That is the portion I remember quite well. I did read that.

By Mr. Alter:

Q. Did you read the last paragraph of this letter?

A. Yes.

The Court: He has read it, he says.

By Mr. Alter:

Q. Was the substance of this letter contained in a copy of the letter which you testified was showed you by the broker in 1953 before you instructed him to buy these bonds?

A. I believe so, because I based my decision primarily on that portion of the ruling.

The Court: Cross-examination?

Mr. Madden: No, I have nothing.

The Court: The witness is excused.

(Witness excused.)

[fol. 24] Mr. Berlin: I don't feel well, Your Honor, may I go?

The Court: There is no reason why he can't be excused, is there?

Mr. Madden: No.

Mr. Berlin: I am not feeling too well.

The Court: You may go.

Mr. Alter: I call Dr. Douglas H. Bellmore to the stand, please.

Douglas H. Bellmore was called as a witness on behalf of the Petitioner and, having been first duly sworn, testified as follows:

The Clerk: Please be seated. Take the witness stand and state your name and address for the reporter.

The Witness: My name is Douglas H. Bellmore, 152 Mountain Avenue, Summit, New Jersey.

Direct examination.

By Mr. Alter:

Q. Dr. Bellmore, what degrees do you hold?

A. Bachelor of Science in Business Administration, Master in Business Administration, Doctor of Philosophy in Economics and Finance.

Q. What was the subject of your doctoral thesis?

A. An Analysis of Public Utility Holding Companies.

Q. What is your present occupation, Dr. Bellmore?

[fol. 25] A. Professor of Finance at the Graduate School of Business, New York University, and director of research, Tucker Anthony and R. L. Day, members of the New York Stock Exchange.

Q. Would you state your experience in the field of economics and corporate finance, briefly?

A. From the time I graduated from college?

Q. Yes, giving the dates, if you will.

A. I was teaching from 1932-35, then I studied for my doctorate at the Graduate School of New York University and at the same time I was working for Durrow and Madden, who were preparing a brief on the Public Utility Holding Company Act of 1935.

Q. What year was that?

A. The summer of 1936.

I then became an associate professor of business administration at Skidmore College. At the same time I was consultant to the Saratoga National Bank.

The following year I became chairman of the Department of Finance at the University of Toledo and did consulting work in investments.

In July, 1942, I entered the service. I will not say anything about that. I will just skip that. I was Purchasing Officer for the Navy in Washington and later Chief of the Finance Division, Public Finance, Eighth Army in the Pacific.

Following the war I became chairman of the Department [fol. 26] of Economics and Finance, Boston University, College of Business Administration. I remained at that position until the summer of 1956. During this period from 1949 to the end of 1956, I was one of the three directors of the American Institute of Finance, Investment Council.

Beginning with 1953, I have been a member of the advisory board of the Edson B. Smith Mutual Fund.

In the summer of 1956, I was appointed professor of finance at the Graduate School of Business of New York University.

In September, 1957, I became associated with Tucker Anthony and R. L. Day, first as a senior analyst and then as a director of research.

Q. Will you state very briefly some of your publications, Dr. Bellmore?

A. I have published three books. "Investments—Principles and Practices" by B. C. Forbes, publisher; "Investment Principles, Practices and Analyses" by B. C. Forbes. I was co-author with the present president of the Federal Reserve Bank of Dallas of a book published in 1956. I have

had numerous articles published in Banking, Journal of the American Bankers Association, Credit and Financial Management, Credit and Financial Chronicle.

Q. Thank you.

In your experience, Dr. Bellmore, are provisions for call [fol. 27] of bonds prior to maturity at alternative prices customary in public utility bond indentures?

A. Yes, they certainly are.

Q. What, briefly, is the purpose of such alternative redemption provisions?

A. The purpose is to permit the corporation to, one, take advantage of lower interest rates by refunding, two, to reduce bonded indebtedness, to convert short term obligations and long term obligations and, finally, to substitute a new bond issue with a new indenture for an old bond issue with an old indenture which has onerous terms in it.

Q. Are there any other purposes for special call at special redemption price?

A. The reason for a special redemption price as you usually find it, is that the issuer may wish to reduce the bonded indebtedness for such things as sinking funds or their equivalent, or if property is going to be sold and no longer used, then the funds could be used to reduce the bond issue under this special amount as provided in the indenture.

Q. Have you read the redemption provisions contained in the mortgage and deed of trust and supplement thereto of the Appalachian Electric Power Company, petitioner's Joint Exhibit 2-B and 3-C?

A. Yes, I have.

Q. Are you familiar with those provisions?

[fol. 28] A. I believe so.

Q. I show you Joint Exhibit 4-D, which sets forth the manner in which the corporation satisfied the requirements under the provisions of the indenture relating to the special funds.

Have you previously consulted this schedule?

A. Yes, I have.

Q. I show you the schedule of the series of bonds under this mortgage of the Appalachian Electric Power Company

set forth in the stipulation of facts in this case. Have you previously seen this?

A. Yes, I have.

Q. Assuming a situation in which bonds of these series were outstanding at October 1953; assuming further that the requirements of the indentures governing those issues had been satisfied in the manner set forth on this schedule shown on Exhibit 4-D; assuming further that the corporation in question had reached a decision to call some of its bonds for redemption at that time of the series then outstanding, which series, in your opinion, would have been the most likely to be called?

A. In my opinion it would be the three and three-quarter series, 1981.

Q. For what reason?

A. For two reasons: One, the fact that that was the highest coupon at that time, and, secondly, they had the [fol. 29] longest—what year are we talking about now?

Q. About October, 1953.

A. They had the longest maturity date.

Q. If you look at this again, I think you may find that the 82 series had about a year longer maturity.

A. There was only one year difference and there was a quarter of a percent difference in the coupon. There wouldn't have been any question. I think they would have taken 81 rather than 82.

Q. That means 81 was higher by a quarter of a percent?

A. That is correct.

Q. Now assuming the facts that I have asked you to assume in the previous question, including the assumption that a decision had been reached to call some of the bonds for redemption, in your opinion, could the corporation have made the call at the special redemption price?

Mr. Madden: Objection, Your Honor.

The Court: On what ground?

Mr. Madden: It calls for a conclusion based upon a matter of law. It is not a matter of economics.

The Court: How about that? How about your opinion?

Mr. Alter: I think the area involved is too technical with respect to the meaning of the practice of redemption at the

special redemption price. An economist specialized in the field would be better qualified to interpret them as to their significance and meaning and be a great help to the Court. [fol. 30] The Court: He may answer for what it may be worth. I am not familiar with the terms of the documents, but I will attempt to familiarize myself with them later to the extent necessary.

He may answer.

The Witness: It seems to me clear from the indenture supplement there, it states: At the regular premium or by use of the proceeds of released property or the proceeds of insurance with a premium equal to a percentage of the principal amount thereof, as set forth in the tabulation below under the heading of "special redemption premium." These are the figures which apply.

The Court: What you are saying is that their financial situation was such that they could proceed under that should they care to?

The Witness: Yes.

Mr. Alter: I would like to offer in evidence a comparative summary of progress contained in the annual report of the Appalachian Power Company, successor to Appalachian Electric Power Company, involved in this case, for the periods '48 to '58.

I offer these and ask to have them marked. I will undertake to furnish copies of the four pages.

The Court: Any objection, Mr. Madden?

Mr. Madden: I just want to take a look, Your Honor. [fol. 31] No objection, Your Honor.

The Court: It may be admitted.

The Clerk: Exhibit 6.

(The document was marked Petitioner's Exhibit No. 6, and received in evidence.)

The Court: You want to substitute copies?

Mr. Alter: Yes.

The Court: No objection?

Mr. Madden: No objection.

The Court: That may be done.

By Mr. Alter:

Q. Referring to the exhibits that you now have, as well as the comparative summary of progress, to what extent,

in your opinion, could the corporation have called bonds for redemption at the special redemption price?

Mr. Madden: Objection to that, Your Honor. Here is an outside expert who is testifying to what extent a corporation could have called bonds. That is irrelevant. It is the men in charge of the company who are going to make the determination when and if, whether they could or could not have, if they had no intention to, or even if they might.

The Court: That is the argument you will make.

You may testify.

(Question read.)

By Mr. Alter:

[fol. 32] Q. We are referring to October, 1953, of course. At October, 1953.

A. I referred earlier to this supplement, and taking that in respect to this exhibit here, I assume, if you look down—

Q. Referring to Exhibit 4-D, is that?

The Court: The last exhibit you handed him.

Mr. Madden: That is 4-D.

By Mr. Alter:

Q. Yes, referring to 4-D.

A. I note that in column 20, 1981, in the second column there, the 1981 series, covering Section 20 of the indenture, it lists annual amounts beginning with 1953. That year it was 283,000. It also, under a column headed Section 40, covering all series of the bonds of the company, lists amounts there in '53 for example, 1,359,000.

Finally, in the column headed Releases for Cash, there shows an amount of that year for 42,626, which actually was withdrawn. There was nothing shown up until '56 in the other two columns.

Q. Referring to that and also to the statement of the company's financial condition which you have, to what extent in the year 1953 could the corporation have called bonds of the 1981 series for redemption at the special redemption price? You will indicate what totals, if any, that you would [fol. 33] take into consideration.

A. To the extent of those totals, it could have made the call.

Q. Which totals?

The Court: The ones he just said. They are already in the record.

By Mr. Alter:

Q. Referring to the totals in the column, only the totals shown in '53?

A. Oh no, no, the totals are shown for previous years in those columns.

Mr. Madden: Excuse me. What columns are you referring to? How are they headed?

The Witness: The first column is headed "20". I assume that means Section 20 there.

By Mr. Alter:

Q. Will you read the full heading?

A. Yes, "Section 20, 1981 series."
"Section 40, All Series Property."
"Releases, Cash."
"Releases, Property."
"Insurance Proceeds, Cash."

Mr. Madden: It is your testimony they could have redeemed bonds to the extent of the totals of all columns appearing on Exhibit 4-D?

[fol. 34] The Witness: No, sir, not to the extent of the first column.

Mr. Madden: I see. Outside of the first column.

By Mr. Alter:

Q. Totals of—

A. There are some footnotes in here which indicate the amounts have already been taken out, but to the extent they haven't been used, they could.

Mr. Alter: No further questions.

The Court: Any cross-examination?

Cross examination.

By Mr. Madden:

Q. Mr. Bellmore, can you tell the Court what the conditions were that had to be met before the 1981 series could be redeemed at the special redemption price?

A. Well, they had to use these proceeds of released property, proceeds of insurance with a premium equal to percentage of the principal amount thereof determined.

Q. So you are reading now from page 31, of Exhibit 3-C, is that right?

A. Yes, sir.

Q. That required the redemption to be made at the special redemption price from cash, is that correct?

A. That would be one.

Q. What are the other wo

[fol. 35] A. By th proceeds of cash, released property or the pr of insurance.

Q. In '53, what were the cash proceeds applicable to the 1981 series?

A. The only item applicable to the '81 series is only the property. Cash, in my understanding, is not just applicable to the '81 series but is applicable to all series.

Q. What are the proceeds of cash applicable to the '81 series in '53?

A. $42,626.30.

Q. What were the proceeds of property releases?

A. There were none in that particular year.

Q. What were the insurance proceeds?

A. There were none in that particular year.

Q. I believe you testified the purpose of these redemption appropriations was to secure lower interest rates, reduced bonded indebtedness, to convert short term to long term bonds and to substitute indentures with better terms from the standpoint of the corporation?

A. And to substitute older property for other property, but those are the others.

Q. An examination of Exhibit 4-D would indicate, would it not, that in 1952 and 1953, as a matter of fact, during the entire history of this corporation, there did not appear

to be any plan to reduce the bonded indebtedness of this [fol. 36] corporation, isn't that correct?

A. Well, it depends what years. Of course, this matter of calling bonds is tied in with the matter of the interest rate.

Q. Just confine yourself, if you will, to my question.

This corporation has issued bonds beginning in 1940, is that correct?

A. '41 is the first figure I have here.

Q. Up through the year 1953 they had increased their bonded indebtedness to some $157,000,000, isn't that correct?

A. That is correct.

Q. Subsequent to '52, the bonded indebtedness also increased, did it not? The indebtedness also increased after '52, isn't that correct?

A. Yes, that is correct.

Q. As a matter of fact there was a total of some $231,000,000, isn't that right?

A. That is correct.

Q. As an expert, would that indicate to you that the corporation was likely to call these bonds for the purpose of reducing a bonded indebtedness?

A. Not for the purpose of reducing bonded indebtedness.

Q. Are you familiar with the money market in 1952, 3 and 5?

A. Yes, I am.

[fol. 37] Could I have the information? It is right there. I have a ten-word statement for example by—

Q. I don't think you will need that.

A. I am familiar but—

Q. I will ask you one question.

A. I am very familiar with the money market.

Q. It is true, is it not, Dr. Bellmore, that the interest rate on bonds was not substantially reduced in the '52-'53 and '54 year period, is that correct?

A. That the rate was not substantially reduced?

Q. Yes, the interest rate, the money rate.

A. That is correct, it never fell below 51.

Q. It is true in determining whether or not to redeem these bonds for the purpose of securing a better interest

rate, a corporation is looking for a substantial reduction in interest rate?

A. I don't know what you mean by "substantial", anything that will really save the cost, they will figure it out actuarially.

Q. They have to balance the cost against the premium they would have to pay, is that correct?

A. The matter of "substantially" has to be defined. You have got bonds in 30 years and a two percent premium spread over the 30 years wouldn't be too much. There would have to be a saving as they would calculate.

[fol. 38] Q. Now, in your opinion, these bonds here which are 30-year bonds, and I believe by examining Exhibit 4-D, there, all the bonds are for a 30-year period. Is that, in your opinion, a short-term bond?

A. No, sir.

Q. I believe you testified that if conditions warranted it and if the corporation did decide to call bonds, was it your opinion that the corporation would call the series 1981 bonds with which we are here involved, is that correct?

A. That is correct.

Q. Would you tell His Honor what conditions would have to be met in your opinion before the corporation would set about calling bonds?

A. Under the regular or special?

Q. Well, I believe I would first confine myself to conditions under which the corporation would call bonds in any event.

A. They would call them when they could replace them by bonds of lower coupon.

Q. Low interest rates?

A. Yes, sir.

Q. I believe you testified that condition did not exist during '53?

A. They never got quite as low as they did in '51. They [fol. 39] came close to it but never quite as low.

Q. What other conditions would have to be met before the corporation could call bonds?

A. They may wish to get rid of a bond issue for other reasons than saving interest rate, as I indicated before. Is that what you mean?

Q. Might I ask you this, Doctor? What conditions, in your opinion, would warrant the calling of bonds, existed with respect to the Appalachian Electric Power Company in 1953?

A. Obviously they didn't, largely because of the factor of expansion which is common to all utilities, their debt has been going up unless there is a reason to substitute the new for the old. Their total debt is going to go up, after all they increased their business, about three times would be required by the Utilities Commissions to do this, to expand.

The Court: In other words, to answer his question, you don't know of any conditions that existed in '53 that might have led them to call any of these bonds?

The Witness: Of course nobody knows the money market. If it had been lower, that would have been different.

The Court: So far as you know, there was nothing existing in late '53 that might have induced them to recall the bonds?

The Witness: No, sir.

[fol. 40] By Mr. Madden:

Q. With respect to the Appalachian Company in particular and with respect to the electric power industry in general, there was an expansion move going on in order to catch up the backlog which had arisen because of the war and these corporations were expanding rather than contracting, increasing their bonded indebtedness rather than cutting it down?

A. Yes, you never know when it is going to stop. We have been levelling off for two years.

Q. As of '53, the picture was one of expansion?

A. That is correct.

Q. Where would the corporation get the money to redeem these bonds at the special redemption price if the corporation is required to redeem such bonds at that price only out of cash and property releases and insurance proceeds?

A. They could only redeem them up to the amounts as shown here but there was no difficulty in this corporation

to getting any amount of money they needed. They could have obtained additional cash by borrowing from the banks, as a matter of fact, which these companies do frequently, make loans from the bank, but they could only use the money up to the extent of these items indicated here in this schedule 4-D.

That is my understanding.

Q. Now, if the corporation desired to redeem these bonds, [fol. 41] then it is true, is it not, that the only columns applicable and the proceeds of which could be used for redemption at the special redemption price were the last three columns on Exhibit 4-D?

A. The last three.

The last three. I repeat, I could use this second column, 20-1981 series, to the extent there was anything in there which there was at the beginning of that year. They could use amounts out of this column which applies to all series.

Mr. Alter: What column?

The Witness: Third column.

By Mr. Madden:

Q. Your testimony is that all the columns, except the first column, are applicable to the redemption of the 1981 series at the special price?

A. Yes, sir, considering the footnotes.

Q. Yes. Now I would like you to look at page 31 of Exhibit 4-D.

Excuse me, 3-C. That is the indenture supplemental to the mortgage. Page 31.

A. Yes.

Q. Now, a special redemption price can be used to redeem these bonds only by the use or application of cash, is that correct?

[fol. 42] Mr. Alter: I don't know where you are reading.

Mr. Madden: Bottom of page 31.

Mr. Alter: Will you show me that?

Mr. Madden: Yes.

Mr. Alter: Would you mind reading the whole thing?

By Mr. Madden:

Q. Will you read the whole statement?

A. I think you have to begin from the beginning of the paragraph "Any."

Mr. Alter: No. I think what Mr. Madden is referring to is the statement beginning here, "And if you mean," leave out the previous part which refers to the previous redemption price. Begin here, but I think every word should be read.

Mr. Madden: Objection. The witness can read the whole paragraph.

The Court: You don't want him to read it into the record.

Mr. Madden: No. Just read the whole paragraph. I will ask you some questions about it.

The Court: It is in the record.

The Witness: Yes, sir.

The Court: He has read it.

By Mr. Madden:

Q. Now, that provides for the manner in which the 1981 series may be redeemed, isn't that correct?

[fol. 43] A. Yes, sir.

Q. And that provides, does it not, that if these are redeemed otherwise than by the use of the application of cash and otherwise than by the use of—

Mr. Alter: Would you read the whole statement?

Mr. Madden: Pardon me, Mr. Alter, you can take it up as you want it.

By Mr. Madden:

Q. I will start all over again. You are able to follow it, are you not?

A. I believe you have to read every word.

Q. I don't want to waste too much time. I am leaving out what to me is the immaterial matter and trying to point out the important point.

A. I don't think anything is unimportant. It is only about 25 words.

Q. Let me ask you this question: Isn't it true that that provision provides that any of the bonds shall be deemed redeemed by the company at the regular redemption premium except when they are redeemed by the use or application of cash, the use of proceeds of released property or the proceeds of insurance, and only under those three circumstances does the special redemption price apply?

A. It doesn't say "except", it says "and". I am not a lawyer, but—

[fol. 44] Q. Where are you reading from?

A. After the term "regular redemption premium." I may have misunderstood you. I thought you said "except."

Q. That is right, I did say "except."

A. Well—

Q. You testified in your opinion that these bonds had to be redeemed at the special redemption price.

A. They had to be redeemed.

Q. I believe you testified if this corporation decided to call any bonds at all, it would call the 1981 series and that if the 1981 series were called, it would be called at the special redemption price?

A. Oh, I didn't testify to that.

Q. That was not your testimony?

A. No, if they were going to call under the conditions like interest rate conditions, they would call at the special redemption price to the amount that they could, then the balance that was outstanding, they would call the rest at the other price.

Q. They would call at the special redemption price only those bonds which could be redeemed out of cash deposited, out of the proceeds of released property, out of the proceeds of insurance—isn't that correct?

A. Out of these columns here, as I see it, the last—all but the first column would provide it.

[fol. 45] Q. Page 31, the last paragraph on page 31, sets forth the conditions under which the special redemption price is applicable, isn't that correct?

A. That is correct.

Mr. Madden: I am sorry to waste so much time on this but I think it is important. I want to go over it again.

By Mr. Madden:

Q. Take another look at the last paragraph on page 31.

The Court: Am I correct in believing that he has already testified in so far as these columns are concerned that relate to the special redemption there is only $42,000 available?

Mr. Madden: That is what I thought he said. All the columns except the first column in Exhibit 4-D. Exhibit 4-D has property additions under the bond indentures. It is respondent's position that these are not applicable to the special redemptions of the redemption price.

The Court: It must be clear from what he has testified to already what he thinks could be used to redeem these particular bonds at the special redemption price. As I heard him say, in three of the columns there wasn't anything. In one of them was $42,000.

The Witness: Yes, that is the cash available.

The Court: Was there anything else in your opinion, Mr. Bellmore?

[fol. 46] The Witness: As I say, in the second and the third column you have amounts which can be used to redeem, but not at the special price.

The Court: That is what I understand.

By Mr. Madden:

Q. It is true, then, that the last three columns are the only columns the proceeds of which can be used to redeem at a special price?

A. No. No, sir. As I testified earlier, all of those—it says if redeemed by use of application of cash deposited first to Section 20 or Section 40 there—and cash could be deposited in relation to these columns here under the indenture, these first two columns. Cash could be—I guess—

The Court: You are not able to state any figure that might be deposited?

The Witness: No.

By Mr. Madden:

Q. This schedule shows property and no cash, isn't that correct?

A. Yes, but that doesn't mean—it provides they could get cash for it.

Q. You are saying they could sell this property?

A. That is right. Or they could, I take it, there is no lien on this particular property, therefore they could obtain funds against that and obtain cash that way and then [fol. 47] use it.

Q. But they would have to go through the mechanics of converting the property to cash?

A. Yes.

Q. And an expanding corporation would not be interested in getting rid of its property, isn't that correct?

A. It depends upon the property. Here they do provide and have at some times. They might want to release certain properties. DuPont just sold a lot of property down in New Jersey for a million dollars. In other words, it is possible.

Mr. Madden: I have nothing further.

The Court: Anything further?

Mr. Alter: I just want to clarify something, I am confused.

Redirect examination.

By Mr. Alter:

Q. I just want to clarify one of the last questions that Mr. Madden asked you.

When you spoke about converting the property deposited under Section 40 or Section 20, into cash, Mr. Madden referred to sale. Could this have been converted otherwise than by sale?

A. If they had cash available, they could put cash in there, they could get cash by a bank loan, put cash in and release it.

[fol. 48] Q. And release the property by putting in cash?

A. Yes, sir.

Q. Mr. Madden asked you about the interest rate in the latter part of 1953 and the likelihood or, rather, lack of likelihood of refinancing in view of the higher interest rate. In view of those facts, in your opinion, was there any likelihood at all, would they consider refinancing at the regular redemption premium?

A. No, no.

Mr. Alter: That is all.

The Court: Anything further?

Mr. Madden: Just one question.

Recross examination.

By Mr. Madden:

Q. Dr. Bellmore, Exhibit 4-D is a schedule of the property utilized and cash deposited by the company under various sections of the mortgage, isn't that correct? That is what it is headed as. Take for example on the first page of that, in 1952, $1,583,333.34 worth of property were utilized under the terms of the mortgage. Now, the mortgage required that a certain amount of property and/or cash be set aside each year to make sure that mortgage was eventually paid, isn't that right? In other words, there was a lien on it, isn't that correct?

A. That is not my understanding of the word "utilization."

[fol. 49] Q. It is dedicated for the purpose of making sure the mortgage was paid, is it not?

A. It is not a lien on it.

Q. It is set aside for the purpose of paying the mortgage?

A. Not in paying. It may be used to reduce it but it may be used for additional property.

Q. But it is for the purpose of making sure that the mortgage is eventually paid. It is protection for the bondholders, isn't that right?

A. It is protection for the bondholders, additional security.

Q. Under those circumstances, would you explain to His Honor how something that is set aside for the protection

of the bondholder can be readily converted into cash otherwise than by sale and the proceeds of sale would necessarily have to be deposited for the protection of the bondholders or other property substituted.

A. It implies in the indenture this could be used to reduce the bonds. This is one of the reasons for having a special indenture price. That is the best protection they can get for the bondholders to use this cash for that purpose under the redemption price. That is the major reason for having it in here.

Q. In other words, a corporation would have to have [fol. 50] sufficient excess property, a property they were desiring to get rid of, and under those circumstances they would convert it into cash and redeem, is that correct?

A. One of the reasons.

Q. Can you explain to His Honor any other reason under which it might be done?

A. If they had surplus cash they would certainly consider using it for that purpose.

Mr. Madden: I have nothing further.

The Court: Your thought is if they had cash under some other category, they might slip the property over for the cash and bring the cash over to this category?

The Witness: That is right.

The Court: No further questions?

Mr. Alter: No.

Mr. Madden: No.

The Court: The witness is excused.

(Witness excused.)

The Court: Do you have anything further?

Mr. Madden: I would like to take a little time to discuss again my motion to quash the subpoena. I am thinking about it and I don't want to underestimate Your Honor's—

The Court: Do you have any further evidence to offer?

Mr. Madden: No. I don't want to underestimate Your Honor's view in the matter, but to respondent, it is clear [fol. 51] this problem of a subpoena being served on respondent for production of rulings which do not relate to the particular taxpayer will open up many things. They

are not relevant. The Commission can change its mind. The Court sustained this when counsel in the Dwyer case went on a fishing expedition of the files in the Internal Revenue Service.

The Court: You said a couple of things, one thing is that it is clear, it is not clear to me, it is just clear to Mr. Madden. I am not talking about a fishing expedition. There is evidence they knew about this before the investment in question was made. There may be some relevance there. I am only talking about admission. There is no use arguing about what weight is to be given to it because that has nothing to do with it at the moment. I only admitted it. I admitted that there is a document which showed these two letters.

Mr. Madden: I am in no position to object if they show the witness a copy of the New York Times and he relied upon the New York Times and he acted in such and such a fashion.

You refused to quash a subpoena which sought from the respondent matters which are confidential and entirely irrelevant.

The Court: But you didn't offer it so there is no reversible error.

Mr. Madden: By refusing to quash a subpoena, you [fol. 52] opened the door to him to put in that court record.

My motion is, Your Honor—

The Court: It might have been admissible in any event even if he didn't get yours because if it is public knowledge that the Commissioner has issued some documents like that, even that might be admissible for the purpose of this case. I am not going to reverse it anyway, Mr. Madden, so there is no use talking about it any more any way.

Mr. Madden: All right. I thought I might have a chance.

The Court: How about the filing of briefs? Do you want to file simultaneous briefs?

Mr. Alter: Yes.

The Court: How long do you think you will need?

Mr. Alter: Sixty days.

The Court: Sixty days for original briefs and 30 days for reply.

The Clerk: Those dates are July 17 and August 19.
The Court: The case stands submitted.

(Whereupon, at 11:40 a. m. the hearing in the above-entitled matter was closed.)

[fol. 52a-1]
[Stamp—Received—Sep. 2, 1959—Tax Court of the U. S.]

[Stamp—12:15 P.M.—Oct. 29, 1958—John O. Anderson, Clerk, By Frank Williams, D. C.]

PETITIONER'S EXHIBIT 5

BEFORE THE TAX COURT OF THE U.S.

Docket No. 68443

IN THE UNITED STATES DISTRICT COURT

FOR THE MIDDLE DISTRICT OF TENNESSEE

Civil Action No. 2292

RILEY L. PARNELL, et ux., Plaintiffs,

vs.

UNITED STATES OF AMERICA, Defendant.

Civil Action No. 2452

J. H. REED, JR., et ux., Plaintiffs,

vs.

UNITED STATES OF AMERICA, Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Plaintiffs in each of these cases, which were consolidated because they involve the same legal question, seek the recovery of alleged overpayments of income taxes with interest. The year involved in the Parnell case was 1952. The year involved in the Reed case is 1954. In each case

the plaintiffs, in computing their income taxes, claimed as a deduction for amortizable bond premium the difference between the cost of bonds purchased by them and the lower of the two alternative prices at which the bonds might be called prior to their maturity. The entire premium was deducted in the year of purchase because the bonds were [fol. 52a-2] callable at either the regular call price or the special call price on thirty days published notice, and the bonds were purchased more than thirty days before the end of the year. The statute involved in the Parnell case is Section 125, Internal Revenue Code of 1939. The statute involved in the Reed case is Section 171, Internal Revenue Code of 1954. The Parnell case involves First Mortgage Bonds, 3¾% Series, due June 1, 1981, of Appalachian Electric Power Company, dated June, 1951, which were purchased by the plaintiff, Riley L. Parnell, on September 23, 1952. The Reed case involved Georgia Power Company First Mortgage Bonds, 3⅜% Series, due 1977, dated December 1, 1947, which were issued in 1947 and purchased by plaintiff, J. H. Reed, Jr., on October 29, 1954. In each case the Commissioner of Internal Revenue disallowed a part of the deduction on the theory that the regular call price of the bonds should have been used rather than the special call price in determining the amount of amortizable bond premium. The regular call price of the Appalachian bonds effective in September, 1952, at the time they were purchased by plaintiff, Riley L. Parnell, was the principal amount plus 5⅝% and the special call price was the principal amount plus 2⅜%.

2. It has long been customary for corporate bonds to contain provisions whereby they may be called or redeemed prior to maturity at descending scales of call prices specified in the indenture. The so-called regular call price is usually higher than the so-called special call price. This [fol. 52a-3] is because the purpose of the general call price is to permit the borrowing company to refinance the indebtedness at a lower interest rate or on better terms. Investors whose bonds are called for this purpose must obtain other investments, and a so-called penalty is provided to compensate them for the lower interest rate they

will obtain. This penalty also serves to discourage the borrower from refinancing merely because of a slight change in interest rates. The special call price, on the other hand, is for the purpose of permitting the borrowing company to utilize, in retiring indebtedness, cash generated from operations and paid into sinking funds and similar funds, according to specified formulae, as well as cash derived from the sale of properties, insurance proceeds, etc. A corollary purpose is to protect the bondholders' security by requiring the aggregate indebtedness to be reduced before maturity, unless additions are made to the mortgaged properties to compensate for the failure to reduce the indebtedness. There are innumerable variations in bond indentures with respect to the conditions under which bonds must be or may be called at the special call prices. It is frequently required that a certain per cent of the original indebtedness be called each year at the special call price out of a sinking fund (or other fund) required to be set aside for that purpose. The company is frequently authorized to tender bonds into the sinking fund (or other fund) in lieu of cash. If cash is deposited, [fol. 52a-4] it may customarily be used to purchase bonds if available at a price lower than the special call price. The company may also be permitted to certify property additions to the trustee in lieu of cash, or to withdraw cash against certification of property additions. In any such event, the property additions may not thereafter be used as the basis for issuing additional bonds, as would otherwise be permitted. Cash not used for these purposes must be used to call bonds. Provisions of this type are customary in public utility bond indentures.

3. Section 20 of the supplemental indenture securing the Appalachian bonds involved in the Parnell case required that, on or before March 1 of each year beginning with the year 1953, the company deposit with the corporate trustee an amount in cash or principal amount of the bonds of that series equivalent to 1% of the greatest principal amount of that series at any time outstanding, but with the privilege to the company of certifying p operty additions in lieu of depositing cash or bonds. In many in-

dentures the term "sinking fund" is used to describe such deposits, but in the Appalachian indenture this terminology is not used. Section 40 of the indenture further required the company, subject to the privilege of certifying property additions, to make annual deposits in cash or principal amount of bonds of any series equal to the amount by which a defined percentage of the base operating revenues during the preceding calendar year exceeded the aggregate amounts expended for repairs and maintenance. The indenture also required the deposit with the corporate trustee of the proceeds of sale of released properties

fire (WEin)

[fol. 52a-5] and ^ insurance proceeds, but permitted this cash to be withdrawn against certification of property additions. Cash held by the corporate trustee and not withdrawn against certification of property additions was required to be used either to call bonds at the special call price or to purchase bonds for retirement. Up to the time of the hearing the company had consistently exercised its privilege of offsetting the annual deposits of cash, which would otherwise have been required, by credits for property additions and waiver of authentication of bonds and by withdrawing proceeds of sale of released properties and insurance for property additions. During the three years 1952, 1953 and 1954 the requirements under Section 20 and Section 40 and the proceeds of released property aggregated $3,150,056.94, so that Appalachian Electric Power Company had the right under the indenture during these three years to call $3,150,056.94 of its bonds of the 3¾% Series, due 1981, at the special call prices, and might have chosen to do so instead of spending this amount of money for property additions and certifying these property additions to the trustee. The company could have used these property additions as the basis for the authentication by the trustee of a new series of bonds, and in that event the company would have deposited cash or bonds with the trustee under Section 20 and Section 40. There were only $17,000,000 bonds of this issue and the company would normally have called them at the special call prices rather than at the regular call prices, if it desired to call them at all, because the special call prices

were lower. At the time of the hearing none of the bonds had been called at either the special call prices or the general call prices.

[fol. 52a-6] 4. The indenture securing the Georgia Power Company bonds contains similar provisions except that, beginning in 1950, the company was required to deposit cash in the sinking fund and was not permitted to certify property additions in lieu thereof. It was, however, permitted to certify property additions for maintenance fund purposes. Cash in these funds could be used to call bonds of any series at the special call price, or to purchase such bonds on the open market. During the years 1950-1958, $13,399,340 in cash was deposited in the sinking fund. Of this amount, $13,064,118.20 was used to call bonds of series other than the series here involved at the special call prices, and $234,165 to purchase bonds of other series. None of the bonds of this particular series have as yet been called at either the special call prices or the regular call prices. During the years 1952-1955 the maintenance fund requirements for all bonds issued under the indenture, including the series here involved, aggregated $18,534,518.16, but these requirements were satisfied by certification of property additions. There were a total of only $10,000,000 bonds outstanding of the series owned by the plaintiff, Reed. If the company had desired to call bonds of this series, it could have done so by utilizing the cash in the sinking fund, or by paying cash into the maintenance fund and using the property additions as the basis for the authentication of bonds of a new series. Again it is obvious that if the company had desired to call bonds of this particular series, it would have normally called them at the special call prices and not the general call prices because the special call prices were lower.

[fol. 52a-7] 5. Regulations 118, Section 39.125(b), states, in effect, that bond premium on any bond to which Section 125 applies shall be determined with reference to "the amount payable at maturity or, in the case of a callable bond, earlier call date." The Regulation further provides:

"... The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different call date in the calculation of amortization deductions with respect to such premium."

The method of determining the amount of bond premium employed by plaintiffs was a method prescribed as reasonable by these regulations, which were issued by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. If, however, the method employed by these plaintiffs was not that prescribed by the regulations, it was nevertheless a reasonable method, as applied to corporate bonds in general, including the bonds here involved, and was regularly employed by the plaintiff taxpayers.

6. It would be impractical to devise a "regular method" of amortizing bond premium which would permit determination of amount of bond premium with reference to call prices in the case of some bonds, but not in the case of other bonds, depending whether or not the particular bonds are "reasonably and realistically callable for redemption" [fol. 52a-8] at such prices. Whether any particular bonds will or will not be called before maturity at either the special call prices or the regular call prices, and if so, how many bonds will be called, and in what year they will be called, are matters which depend upon varying indenture provisions and upon unpredictable future conditions and company policies.

7. In 1956 the Commissioner of Internal Revenue published Revenue Ruling 56-398, which contained the following language but did not indicate the particular bonds involved:

"... In permitting amortizable bond premium deductions upon the 'earlier [than maturity] call date.' section 125 of the 1939 Code and the regulations applicable thereunder contemplated that there be the likelihood of general redemption, in whole or in specified or ascertainable part, of the bond issue or series, so that a bondholder is enabled to establish that his bond or bonds is then reasonably and realistically callable for redemption at a certain price. As between the 'special' and 'general' redemption prices provided for in respect of the instant bonds, this manifestly is true regarding the latter but not the former (in advance of actual notice of call.)"

The Appalachian and Georgia bonds involved in this cause were "reasonably and realistically callable for redemption" at the special call prices in the sense that holders of these bonds might reasonably anticipate calls prior to maturity at these prices. These special call prices were not "a mere sham" as contended by defendant in its brief, but were for a bona fide business purpose.

[fol. 52a-9] 8. In 1952 the Commissioner sent the following ruling letter to a taxpayer:

"Gentlemen:

"Reference is made to your letter of November 1, 1952, referring to a ruling of the Bureau dated July 30, 1952, in which it was held that the earliest call date for Appalachian Electric Power Company bonds would be thirty days after notice of redemption is received, except that if no such notice has been received on the date the decision to amortize bond premium under section 125 of the Internal Revenue Code is made with respect to such bonds, the earliest call date would be thirty-one days after the date of such decision.

"The Appalachian Electric Power Company 3¾% bonds, 1981 Series, are callable in whole or in part through May of 1953 at 105⅝. They are also callable for sinking fund through funds derived from maintenance or sale of property at any time upon thirty days notice through May 31, 1954 at 102⅜. You request to

be advised whether the above-mentioned ruling of July 30, 1952, means that such bonds may be amortized down to 102⅜ or whether it means that they can only be amortized down to 105⅝ through May of 1953.

"Upon the basis of the information on file in this office, it is the opinion of this office that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Code may use the regular redemption price of 105⅝ or the special redemption price of 102⅜.

"Very truly yours,

Norman A. Sugarman, Assistant Commissioner

By (signed) H. T. Swartz
Head, Technical Ruling Division"

[fol. 52a-10] In 1956 the ruling was revoked by the following letter:

"Gentlemen:

"Reference is made to our letter dated December 2, 1952, in which you were advised that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Internal Revenue Code of 1939 may use the regular redemption price of 105⅝ or the special redemption price of 102⅜.

"The question of the redemption price to be used has been reconsidered, and it is now the conclusion of this office that the bond premium under section 171 of the 1954 Code (section 125 of the 1939 Code) on an earlier (than maturity) call date basis should not be computed, with respect to the above-mentioned bonds, with reference to the special redemption prices set forth in the prospectus thereon, except as to any particular bonds or portion thereof with respect to which actual notice of call on a specific or ascertainable date has been issued, but should be made with reference to the general redemption prices set forth in the prospectus.

"Accordingly, the ruling contained in our letter dated December 2, 1952, is hereby revoked.

"Pursuant to authority contained in section 7805(b) of the 1954 Code, this ruling will not be applied with respect to bonds purchased by you prior to the date of this letter.

Very truly yours,

(Signed) Russell C. Harrington
Commissioner"

Similar rulings had been made in 1952 with respect to certain bonds of Hartford Electric Light Company and Chesapeake & Ohio Railway Company, and were likewise revoked on March 22, 1956, "to the extent that . . . [they] were interpreted as meaning that the special redemption price could be used . . . " None of these rulings were published, [fol. 52a-11] but were produced by the defendant in response to interrogatories filed by plaintiff in this case. They are relevant only as indicating the Commissioner's earlier administrative construction of his own regulations with respect to what was a reasonable method of determining the amount of bond premium to be amortized.

9. The Appalachian bonds involved in the Parnell case were sold in 1953 at a profit, and a tax paid on the capital gain. The adjustment made by the Internal Revenue Service for the year 1952 in disallowing the deduction of the difference between the special call price and the general call price of these bonds automatically required a corresponding adjustment in the capital gain realized in 1953, with a resulting overassessment in favor of plaintiffs. The defendant has filed a counterclaim asking that this 1953 adjustment be reversed in the event of a decision for the plaintiffs. In the Reed case, it appears that plaintiffs had purchased other bonds in 1953 and had employed the same method of amortizing bond premium, and that the Commissioner of Internal Revenue asserted a deficiency in 1953 with respect to which the plaintiffs are seeking a redetermination in the Tax Court. These bonds were sold in the year 1954, and in computing the 1954 deficiency the Internal Revenue Service adjusted the capital gains in favor of the plaintiffs. The defendant seeks a reversal of

these adjustments in the event of a decision for the plaintiffs.

[fol. 52a-12] 10. Plaintiffs in each case filed a timely claim for refund setting forth the grounds subsequently relied upon in their respective complaints. These claims for refund were disallowed prior to the filing of the respective actions.

CONCLUSIONS OF LAW

1. The Court has jurisdiction over this case by virtue of 28 U. S. C., Section 1346(a)(1).

2. Plaintiffs were entitled to the deductions taken on their respective tax returns for amortization of bond premium pursuant to Section 125, Internal Revenue Code of 1939, in the Parnell case, and Section 171, Internal Revenue Code of 1954, in the Reed case. Cf. Commissioner v. Korell, (1950) 339 U. S. 619.

3. Judgment shall be entered in favor of the plaintiffs in each case. In the Parnell case judgment for the defendant shall be entered on its counterclaim for the year 1953. In the Reed case, the judgment shall be without prejudice to the right of the defendant to assess and collect from the plaintiffs the amount of the 1954 adjustment in capital gains taxes in the event the final decision of the Tax Court is that plaintiffs were entitled, under Section 125, Internal Revenue Code of 1939, to the full deductions taken on their returns for the year 1953 which is before the Tax Court. Plaintiffs in each case shall recover the interest [fol. 52a-13] assessed against them and paid, together with interest on the respective items of recovery as provided by law, and allowable costs.

/s/ (Illegible)
Judge

A TRUE COPY

Attest:

CARL W. REUSS, Clerk

By /s/ MARY M. MCAFEE
Deputy Clerk

(Seal)

[fol. 52a-14]
[Stamp—Nov. 6, 1956—L. B. Ormes, Clerk, By Guy W. Cooper, D. C.]

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
Civil Action No. 2292

RILEY L. PARNELL and IRENE F. PARNELL,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

To: Fred Elledge, Jr.,
United States Attorney.

Sir:

The plaintiffs request that the defendant, by the Commissioner of Internal Revenue, or a Deputy Commissioner of Internal Revenue, answer under oath, in accordance with Rule 33 of the Federal Rules of Civil Procedure, the following interrogatories:

1. List the rulings given by the Office of the Commissioner of Internal Revenue during the years 1947-1954, inclusive, in response to inquiries of taxpayers as to their right under Section 125, Internal Revenue Code of 1939, as amended, to deduct from gross income the amount of bond premium determined with reference to the amount payable on a call date earlier than maturity, identifying each ruling by (1) date of ruling letter, (2) name of indi-
[fol. 52a-15] vidual in the office of the Commissioner of Internal Revenue who signed the ruling letter, (3) description of the bonds involved, and (4) the redemption or call price with reference to which taxpayer proposed to determine the amount of bond premium. Please omit from this list of rulings any rulings with respect to bonds which had no provisions authorizing redemption for sinking fund purposes, or redemption with cash in other special funds, at lower redemption or call prices than the general redemption or call prices of such bonds.

2. Attach copies of the inquiries from taxpayers in response to which the rulings listed in answer to Interrogatory 1 were made, and copies of the rulings themselves, omitting names and addresses of taxpayers if deemed confidential or privileged; or, in the alternative, if the furnishing of such copies is deemed burdensome, state the substance of the rulings.

3. If any of the rulings listed in answer to Interrogatory 1 were subsequently revoked, give dates of revocation and attach copies of the letters of revocation, omitting names and addresses of taxpayers if deemed confidential or privileged; or, in the alternative, if the furnishing of such copies is deemed burdensome, state what portion or portions of the rulings were revoked, and the effective dates of the revocations.

Please take notice that copy of such answers must be served upon the undersigned within fifteen (15) days after [fol. 52a-16] the service of these interrogatories.

Dated November 5, 1956.

WALLER, DAVIS & LANSDEN,
Attorneys for Plaintiffs

By /s/ WILLIAM WALLER
A member of the firm

American Trust Building,
Nashville 3, Tennessee

I certify that the foregoing interrogatories were served on defendant by mailing three copies of same to Hon. Fred Elledge, Jr., United States Attorney, U. S. Courthouse, Nashville, Tennessee, this November 5, 1956.

/s/ WILLIAM WALLER

A TRUE COPY

Attest:

CARL W. REUSS, Clerk

By /s/ MARY M. MCAFEE
Deputy Clerk

(Seal)

[fol. 52a-17]
[Stamp—Filed—Aug. 29, 1957—John O. Anderson, Clerk, By Frank Williams, D. C.]

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
Civil Action No. 2292

RILEY L. PARNELL and IRENE F. PARNELL,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

ANSWERS TO INTERROGATORIES PROPOUNDED BY PLAINTIFFS

Comes now the defendant by its attorney, Fred Elledge, Jr., United States Attorney for the Middle District of Tennessee, and answers the interrogatories propounded by plaintiffs pursuant to Rule 33 of the Federal Rules of Civil Procedure, as follows:

1. In response to plaintiffs' interrogatory number one (1), which relates to rulings given by the Office of the Commissioner of Internal Revenue during the years 1947-1954, inclusive, in response to inquiries of taxpayers as to their right under Section 125 of the Internal Revenue Code of 1939, as amended, to deduct from gross income the amount of bond premium determined with reference to the amount payable on a call date earlier than maturity, and in compliance with the Order of this Court filed on August 12, 1957, there is attached hereto and made a part hereof copies of rulings made available by the Internal Revenue Service to the attorney for the defendant, the information sought to be obtained by plaintiffs' interrogatory being reflected on such exhibits.

2. In response to plaintiffs' interrogatory number two (2), which relate to the inquiries from taxpayers in response to which the rulings referred to in interrogatory

number one (1) were made, as well as the rulings themselves, and in compliance with the Order of this Court filed on August 12, 1957, there is attached hereto and made a part hereof a copy of such correspondence and rulings, the information sought to be obtained by plaintiffs' interrogatory being reflected on such exhibits.

[fol. 52a-18] 3. In response to plaintiffs' interrogatory number three (3), which relates to the revocation of the rulings referred to in interrogatory number one (1), and in compliance with the Order of this Court filed on August 12, 1957, there is attached hereto and made a part hereof a copy of such letters of revocation, the information sought to be obtained by plaintiffs' interrogatory being reflected on such exhibits.

/s/ Fred Elledge, Jr.
Fred Elledge, Jr.
United States Attorney
Attorney for Defendant

A True Copy

Attest:

Carl W. Reuss, Clerk

By /s/ Mary M. McAfee
Deputy Clerk

(Seal)

[fol. 52a-19]

January 31, 1952

Commissioner of Internal Revenue
Washington 25, D. C.

Gentlemen:

I am a taxpayer situated in Boston, Massachusetts. I own the following bonds:

Appalachian Electric Power Co. first 3¾s, due 1981

Hartford Electric Light Co. debenture 3¼s, 1971

Chesapeake & Ohio Railway Co. refunding and improvement 3⅞s series H

It is my intention to take amortization of the premium on these bonds as follows:

On the Appalachian Electric Power to 102⅜, as provided for in the maintenance and improvement fund, or from the proceeds of released property, or insurance.

• • •

With respect to the Hartford Electric Light Company debentures, I have owned these bonds for some time and bonds have been called at 100 for the sinking fund.

With respect to the Chesapeake and Ohio's, I have owned these for some time, and I have had called a number of these bonds for the sinking fund at 101⅛.

I seek a ruling which would permit me to take amortization on the foregoing bonds, as follows:

Appalachian Electric Power Co., to 102⅜, during this taxable year at the expiration of 31 days.

Hartford Electric Light Co., to 100, on March 1, which is an interest date.

[fol. 52a-20]

Chesapeake & Ohio Railway Co., to 101⅛, on June 1, which is an interest date.

The letter, statement, and Prospectus herewith submitted are a part of this request and are hereby incorporated into it by reference.

Respectfully submitted,

[fol. 52a-21]

COPY

MAR 14 1952

Dear

Reference is made to your letter of January 31, 1952, stating that you are the owner of bonds of the Appalachian Electric Power Company, first 3¾s, due 1981, Hartford Electric Light Company debenture 3¼s, due 1971, and Chesapeake & Ohio Railway Company refunding and improvement 3⅞s, Series H, and requesting to be advised with respect to the amortization of the premium on such bonds. A chart showing the call provisions of these bonds accompanied your letter, together with a letter from * * * * and a copy of a prospectus of the Appalachian Electric Power Company.

In accordance with the provisions of section 125 of the Internal Revenue Code, it is optional, at the election of the taxpayer, as to whether an individual may amortize a premium applicable to a taxable bond. The election to amortize bond premiums as provided by section 125 of the Code shall be made by the taxpayer by claiming a deduction for the bond premium in his return for the first taxable year to which he desires the election to be applicable. No other method of making such election is permitted.

If the election is so made, the taxpayer should attach to his return a statement showing the computation of the deduction. The election shall apply to all bonds of the class or classes selected owned by the taxpayer at the beginning of the first taxable year to which the election applies and also to all bonds of such class (or classes) thereafter acquired by him, and shall be binding for all subsequent years, unless authorized by the Commissioner to change.

Bond premium on any bond to which section 125 of the Code applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. The earlier call date may be the earliest call date specified in the bond as a certain day, the earliest interest payment date if the bond is callable at

such time, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different date in the calculation of amortization deductions with respect to such premiums.

[fol. 52a-22] Upon the basis of the information submitted and the foregoing provision of law it is the opinion of this office that you may elect to amortize the premium on the Appalachian Electric Power Company bonds over the life of the bond or to any May 31; that the premium on the bonds of the Hartford Electric Light Company may be amortized over the life of the bonds or to any call date beginning after September 1, 1956, and that the premium on the bonds of the Chesapeake & Ohio Railway Company may be amortized over the life of such bonds or to any November 30.

Very truly yours,

(Signed) E. I. McLarney
Deputy Commissioner

[fol. 52a-23]

COPY

MAR 22 1956

Dear

Reference is made to our letter to you dated March 14, 1952, and our letter dated July 30, 1952, • • • • relative to the amortization of bond premiums on certain bonds of Appalachian Electric Power Company, Hartford Electric Light Company and Chesapeake and Ohio Railway Company.

The question as to whether the general redemption price or the special redemption price should be used for the purpose of computing the bond premium amortization has been reconsidered and it is now the conclusion of this office that the bond premium under section 171 of the Internal Revenue Code of 1954 (section 125 of the 1939 Code) on an earlier (than maturity) call date basis should not be com-

puted, with respect to the above-mentioned bonds, with reference to the special redemption prices set forth in the prospectus thereon, except as to any particular bonds or portion thereof with respect to which actual notice of call on a specific or ascertainable date has been issued, but should be made with reference to the general redemption prices set forth in the prospectus.

Accordingly, to the extent that the rulings contained in the above-mentioned letters were interpreted as meaning that the special redemption price could be used, such rulings are hereby revoked.

Pursuant to authority contained in section 7805(b) of the 1954 Code, this ruling will not be applied with respect to bonds purchased by you prior to the date of this letter.

Very truly yours,

(Signed) Russell C. Harrington
Commissioner

[fol. 52a-24] May 12, 1952

Commissioner of Internal Revenue,
Washington, D. C.

Dear Sir:

Reference is made to letter opinion dated March 14, 1952, addressed to * * * bearing the above symbols and signed by E. I. McLarney, Deputy Commissioner.

* * * is having some difficulty in reconciling the specific opinion in the last paragraph of said letter with the general statements of the applicable law contained in the preceding paragraphs of said letter.

In the general statement it appears that "Bond premium on any bond to which section 125 of the Code applies is the excess of the amount of the bases (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date."

Reg. 111, Sec. 29.125-3 appears to sanction the amortization of the amount of the bond premium over a period ending with the date of maturity or earlier call date.

The Appalachian Electric Power Company bonds inquired about are callable *at any time,* provided only that notice is given by specified publication at least 30 days prior to the call date. The earlier call date on such bonds is therefore 30 days after acquisition.

The last paragraph of the referred to letter states that "You may elect to amortize the premium on the Appalachian Electric Power Company bonds over the life of the bond or *to any May 31.*" This would appear to be the case if May 31 of each year constituted the earlier call date. According to the information furnished with the original request for opinion, May 31 is not a call date, but is merely a date on which the call price changes. The call date is still *at any time,* subject only to the requirement of a 30 day notice. It would appear therefore that, to be unam-[fol. 52a-25] biguously consistent with the general principles in the preceding part of the said letter such last paragraph should read: "You may elect to amortize the premium on the Appalachian Electric Power Company bonds over the life of the bond or to the earlier call date, which is 30 days after the date of acquisition."

In regard to the Hartford Electric Light Co. bonds the last paragraph states that the premium "may be amortized over the life of the bonds or to any call date beginning after September 1, 1956."

According to the information contained in Moody's which was submitted with the original request for opinion, there are two call provisions incorporated in these bonds, a general call provision operative after September 1, 1956 and also a call provision making the bonds callable for the sinking fund "on any interest date at 106 to September 1, 1946, inclusive., and at 100 thereafter." The sinking fund provisions also require the retirement, through purchase or call, of a specified percentage of bonds annually so as to retire the entire issue at or before maturity.

It would accordingly appear that this second call provision would constitute any interest date as the "earlier call date" and that the referred to part of the said last paragraph should state that the premium on the Hartford Electric Light Co. bonds "may be amortized over the life of the bonds or to the earlier call date referred to in your request, which is the first interest date after acquisition."

In regard to the Chesapeake & Ohio bonds the last paragraph states that the premium "may be amortized over the life of such bonds or to any November 30th."

These bonds also, according to the information contained in Moody's which was submitted with the original request for opinion, have two call provisions, one a general call provision and the other a call provision for the sinking fund. The bonds are callable on notice of not less than 30 nor more than 50 days "on any interest date beginning December 1, 1949, at sinking fund redemption prices to each June 1, incl.," as set forth.

It would accordingly appear that this second call provision would constitute the first interest date more than 30 [fol. 52a-26] days after acquisition as the "earlier call date" and that the referred to part of the said last paragraph should state that the premium on the Chesapeake & Ohio bonds "may be amortized over the life of the bonds or to the earlier call date referred to in your request, which is the first interest date falling more than 30 days after acquisition." The June 1 date in the second call provision as well as the November 30 date in the general call provision is merely the date on which the call price changes, and is not a call date.

We would greatly appreciate your revising the last paragraph of the letter opinion referred to so as to eliminate the apparent inconsistencies herein pointed out between that paragraph and the main portion of the said letter opinion.

We are enclosing herewith power of attorney from * * * authorizing this request to be made on his behalf.

Very truly yours,

[fol. 52a-27] COPY

JUL 30 1952

Gentlemen:

Reference is made to your letter of May 12, 1952, referring to previous correspondence between this office and * * * * relative to the amortization of bond premium on certain bonds of Appalachian Electric Power Company, Hartford Electric Light Company and Chesapeake and Ohio Railway Company. * * * *

You state that * * * * is having some difficulty in reconciling the specific opinion in the last paragraph of Bureau letter of March 14, 1952, with the applicable provisions of law contained in that letter, and request that such paragraph be revised to eliminate the apparent inconsistencies.

The last paragraph of Bureau letter of March 14, 1952, is hereby revised to read as follows:

"Upon the basis of the information submitted and the foregoing provision of law, it is the opinion of this office that you may elect to amortize the premium on the above-mentioned bonds over their respective lives, or to such earlier call date as is specified in the bonds, in accordance with the provisions of section 125 of the Internal Revenue Code and the regulations promulgated thereunder.

"Upon the basis of the information presented the earliest call date for the Appalachian Electric Power Company bonds would be thirty days after notice of redemption is received, except that if no such notice has been received on the date the decision to amortize bond premium under section 125 of the Internal Revenue Code is made with respect to such bonds the earliest call date would be thirty-one days after the date of such decision.

"The earliest call date with respect to the Hartford Electric Light Company debentures would be the date specified in any notice of redemption properly issued by the company. Where no such notice has been received at the time the decision to amortize bond premium under section 125 of the Code with respect to such debentures is

[fol. 52a-28] made the earliest call date would be the next interest payment date following the date of such decision, except that subsequent to September 1, 1956 the earliest call date would be the thirty-first day following the date upon which such decision is made or an earlier interest payment date falling within such thirty-one day period.

"The earliest call date with respect to the Chesapeake and Ohio Railway Company bonds would be the first interest payment date which falls more than thirty days after notice of redemption is received, except that if no such notice has been received when the decision to amortize bond premium under section 125 of the Code is made with respect to such bonds the earliest call date would be the thirty-first day following the day upon which such decision is made."

Very truly yours,

(Signed) E. I. McLarney
Deputy Commissioner

[fol. 52a-29] November 1, 1952

Commissioner of Internal Revenue
U. S. Treasury Department
Washington 25, D.C.

Dear Sir:

Under date of July 30, 1952, Mr. E. I. McLarney, Deputy Commissioner gave a letter to * * * * with reference to Appalachian Electric Power Company bonds. Following is a quote from this letter:

> "Upon the basis of the information submitted and the foregoing provision of law, it is the opinion of this office that you may elect to amortize the premium on the above-mentioned bonds over their respective lives, or to such earlier call date as it is specified in the bonds, in accordance with the provisions of section 125 of the Internal Revenue Code and the regulations promulgated thereunder."

"Upon the basis of the information presented the earliest call date for the Appalachian Electric Power Company bonds would be thirty days after notice of redemption is received, except that if no such notice has been received on the date the decision to amortize bond premium under Section 125 of the Internal Revenue Code is made with respect to such bonds the earliest call date would be thirty-one days after the date of such decision." End of quote—

The Appalachian Electric Power Company 3¾% bonds, 1981 Series are callable in whole or in part through May 1953 at 105⅝. They are callable for sinking fund through funds derived from maintenance or sale of property at any time upon thirty days notice through May 1, 1952 to 1954 at 102⅜.

Does the decision above referred to mean that these bonds may be amortized down thirty days after such decision is made to 102⅜, or does it mean they can only be amortized down to 105⅝ through May 1953.

[fol. 52a-30] I would appreciate it if you would wire me collect your decision.

Very truly yours,

[fol. 52a-31] COPY

DEC 2 1952

Gentlemen:

Reference is made to your letter of November 1, 1952, referring to a ruling of the Bureau dated July 30, 1952, in which it was held that the earliest call date for Appalachian Electric Power Company bonds would be thirty days after notice of redemption is received, except that if no such notice has been received on the date the decision to amortize bond premium under section 125 of the Internal Revenue Code is made with respect to such bonds, the earliest call date would be thirty-one days after the date of such decision.

The Appalachian Electric Power Company 3¾% bonds, 1981 Series, are callable in whole or in part through May of 1953 at 105⅝. They are also callable for sinking fund through funds derived from maintenance or sale of property at any time upon thirty days notice through May 31, 1954 at 102⅜. You request to be advised whether the above-mentioned ruling of July 30, 1952, means that such bonds may be amortized down to 102⅜ or whether it means that they can only be amortized down to 105⅝ through May of 1953..

Upon the basis of the information on file in this office, it is the opinion of this office that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Code may use the regular redemption price of 105⅝ or the special redemption price of 102⅜.

Very truly yours,

Norman A. Sugarman, Assistant Commissioner

By (Signed) H. T. Swartz
Head, Technical Ruling Division

[fol. 52a-32] COPY

MAR 22 1956

Gentlemen:

Reference is made to our letter dated December 2, 1952, in which you were advised that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Internal Revenue Code of 1939 may use the regular redemption price of 105⅝ or the special redemption price of 102⅜.

The question of the redemption price to be used has been reconsidered, and it is now the conclusion of this office that the bond premium under section 171 of the 1954 Code (section 125 of the 1939 Code) on an earlier (than maturity) call date basis should not be computed, with respect to the above-mentioned bonds, with reference to the special

redemption prices set forth in the prospectus thereon, except as to any particular bonds or portion thereof with respect to which actual notice of call on a specific or ascertainable date has been issued, but should be made with reference to the general redemption prices set forth in the prospectus.

Accordingly, the ruling contained in our letter dated December 2, 1952, is hereby revoked.

Pursuant to authority contained in section 7805(b) of the 1954 Code, this ruling will not be applied with respect to bonds purchased by you prior to the date of this letter.

Very truly yours,

(Signed) Russell C. Harrington
Commissioner

[fol. 52a-33]

Oct 7, 1953

COMMISSIONER OF INTERNAL REVENUE

MY INVESTMENT ADVISERS HAVE RECOMMENDED TO ME THAT I MAKE AN INVESTMENT IN APPALACHIAN ELECTRIC POWER COMPANY FIRST MORTGAGE BONDS, 3-¾ PERCENT SERIES DUE 1981. THE PRESX MARKET PRICE OF THESE BONDS IS APPROXIMATELY $117.00 PER $100.00 BOND. THEY HAVE TOLD ME THAT THE BONDS ARE CALLABLE FOR REDEMPTION AT ANY TIME ON THIRTY DAYS NOTICE AT $102.37½ PER $100.00 BOND.

I HAVE ALSO BEEN ADVISED THAT IF I PURCHASE THESE BONDS TOMORROW, OCTOBER 8, 1953, WITH SETTLEMENT DATE OCTOBER 14, 1953, AND IF I ELECT TO AMORTIZE THE PREMIUM WHICH I PAY ON SAID BONDS THE VERY NEXT DAY, AND IF THE BONDS ARE NOT CALLED FOR REDEMPTION PRIOR TO NOVEMBER 14, 1953, THAT UNDER SUCH CIRCUMSTANCES, I MAY CLAIM A DEDUCTION ON MY 1953 INCOME TAX RETURN OF THE DIFFERENCE BETWEEN THE TOTAL

AMOUNT WHICH I PAY PER BOND ($117.00 PLUS THE COMMISSION) AND $102.37½ THE LATTER [fol. 52a-34] FIGURE BEING THE SPECIAL REDEMPTION PRICE.

I HAVE NEVER ELECTED TO CLAIM AMORTIZATION OF BOND PREMIUM ALTHOUGH WHEN MY WIFE WAS ALIVE, SHE OWNED CERTAIN BONDS ON WHICH SHE CLAIMED AMORTIZATION OF BOND PREMIUM WHEN WE FILED A JOINT RETURN. I FILE MY RETURN ON A CASH BASIS AND ON A CALENDAR YEAR BASIS.

MY INVESTMENT ADVISERS HAVE TOLD ME THAT THEY UNDERSTAND YOU HAVE ALREADY CONSIDERED THIS PROBLEM AND HAVE RULED THAT THE PREMIUM IS DEDUCTIBLE IN ACCORDANCE WITH THE WAY THEY HAVE TOLD ME IT COULD BE DEDUCTED IF I ELECT TO CLAIM AMORTIZATION OF BOND PREMIUM ON MY 1953 RETURN.

I HAVE PLACED AN ORDER FOR THE PURCHASE OF $125,000 FACE AMOUNT OF THESE BONDS, WHICH ORDER IS NOT TO BE EXECUTED UNTIL I GET A REPLY FROM YOU RESPECTING THE TAX TREATMENT, NOT ONLY WITH RESPECT TO THE DEDUCTIBILITY OF THE BOND PREMIUM (IF I MAKE THE ELECTION) BUT ALSO WITH RESPECT TO WHAT AMOUNT ON WHICH I MUST FIGURE MY PROFIT OR LOSS IF I SHOULD LATER SELL THE BONDS, HAVING CLAIMED THE AMORTIZATION DEDUCTION.

SINCE THE MARKET PRICE MAY GO UP, AN IMMEDIATE REPLY WILL BE APPRECIATED. PLEASE TELEGRAPH ME COLLECT SO I CAN ACT IMMEDIATELY.

[fol. 52a-35] COPY

Oct 16 1953

Dear

This is in reply to your telegram of October 7, 1953, relative to amortization of bond premium on Appalachian Electric Power Company First Mortgage Bonds 3¾% Series of 1981.

You state the present market price is $117.00 and that you have been advised that such bonds are callable at any time on thirty days notice at 102.37½ and that if such bonds are purchased and you elect to amortize the premiums you may claim a deduction on your 1953 return for the difference between the cost, plus commissions, and the redemption price.

You request to be advised with respect to the matter and also as to the basis on which you must figure gain or loss in the event you have claimed the amortization deduction.

Upon the basis of the information contained in the files of this office, it has been held that a taxpayer electing to amortize the premium on Appalachian Electric Power Company 3¾% Bonds, Series of 1981, in accordance with section 125 of the Internal Revenue Code may use the regular redemption price of 105⅜, if redeemed during the twelve months beginning June 1, 1953, or the special redemption price of 102⅜, if redeemed during the twelve months beginning June 1, 1953.

It has been further held that the earliest call date for these bonds is thirty days after notice of redemption is received, except that if no such notice has been received on the date the decision to amortize bond premium under section 125 of the Code is made with respect to such bonds, the earliest call date would be thirty-one days after the date of such decision.

With respect to the basis to be used in computing gain or loss, if amortization is claimed on the basis of the special redemption price of 102⅜, the basis for computing

gain or loss will be 102⅜ plus the commissions paid at the time of purchase.

Very truly yours,

(Signed) Lester W. Utter

Acting Chief
Individual Income Tax Ruling Branch

[fol. 52a-36] COPY

MAR 22 1956

Dear

Reference is made to our letter to you dated October 16, 1953, in which you were advised, in part, that a taxpayer electing to amortize the premium on Appalachian Electric Power Company 3¼% bonds, Series of 1981, in accordance with section 125 of the Internal Revenue Code may use either the regular or the special redemption price.

The question of the redemption price to be used has been reconsidered and it is now the conclusion of this office that the bond premium under section 171 of the 1954 Code (section 125 of the 1939 Code) on an earlier (than maturity) call date basis should not be computed, with respect to the above-mentioned bonds, with reference to the special redemption prices set forth in the prospectus thereon, except as to any particular bonds or portion thereof with respect to which actual notice of call on a specific or ascertainable date has been issued, but should be made with reference to the general redemption prices set forth in the prospectus.

Accordingly, the ruling contained in our letter dated October 16, 1953, is hereby revoked.

Pursuant to authority contained in section 7805(b) of the 1954 Code, this ruling will not be applied with respect to bonds purchased by you prior to the date of this letter.

Very truly yours,

(Signed) Russell C. Harrington
Commissioner

[fol. 52a-37]

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

I, Carl W. Reuss, Clerk of the United States Court of Appeals for the Sixth Circuit, do hereby certify that the foregoing are true and correct copies of correspondence and rulings of the Commissioner of Internal Revenue, attached to the Answers to Interrogatories Propounded by Plaintiffs, in the case of

United States of America

vs.

Riley L. Parnell, et al.,

No. 13,831, as the same remains upon the files and records of said United States Court of Appeals for the Sixth Circuit, and of the whole thereof.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of said Court at the City of Cincinnati, Ohio, this 12th day of May, A.D. 1959.

/s/ CARL W. REUSS
Clerk of the United States Court of Appeals for the Sixth Circuit.

[Seal]

[fol. 53]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 68443

ESTATE OF A. GOURIELLI, DECEASED, AND HELENA GOURIELLI, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION—Filed June 26, 1957

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (symbols UM:Au:R:EF:mw) dated April 12, 1957, and as a basis of their proceeding, allege as follows:

1. Petitioner Helena Gourielli is the surviving wife of A. Gourielli, Deceased. The said A. Gourielli and Helena Gourielli, were husband and wife during the taxable year ended December 31, 1953, and filed a joint Federal Income Tax Return with the District Director of Internal Revenue for the District of New York, Upper Manhattan.

2. The Notice of Deficiency (a copy of which, together with the accompanying statement, is attached hereto and marked "Exhibit A") is dated April 12, 1957.

[fol. 54] 3. The deficiency as determined by the Commissioner of Internal Revenue is in income tax for the taxable year 1953, in the amount of $14,200.92, all of which deficiency is in controversy.

4. The determination of tax set forth in said Notice of Deficiency is based upon the following errors:

a) The Commissioner erred in disallowing, in part, the deduction claimed on petitioners' return for bond premium amortization.

b) The Commissioner erred in holding that, to the extent of such disallowance, the deduction for bond premium

[Stamp—Served Jul 2—1957, Entered Jul 2—1957]

amortization has not been substantiated as an allowable deduction under the provisions of the Internal Revenue Code.

5. The facts upon which petitioners rely as the basis of this proceeding are as follows:

a) In or about October, 1953, petitioners purchased 540 Appalachian Electric Power Company First Mortgage Bonds of the 1981 series.

b) The purchase price per bond was, exclusive of commissions, $1,175.00, or at a premium of 17½% above the face amount of each bond.

c) Under the terms of the indenture covering the bonds in question, petitioners' bonds were subject to call and redemption on thirty days' notice at a price of $1,023.75 per bond.

d) Petitioners duly made and filed a joint United States Individual Income Tax Return (Form 1040) for the taxable year 1953 claiming a deduction for bond premium [fol. 55] amortization under the provisions of Section 125 of the Internal Revenue Code of 1939, in the amount by which their purchase price of the bonds, plus commissions, exceeded such redemption price.

Wherefore, the petitioners pray that the Court may hear the proceeding, determine that there is no deficiency in income tax due from petitioners for the calendar year 1953, and give such other and further relief as in the premises it may deem fit and proper.

David Alter, Counsel for Petitioners, 274 Madison Avenue, New York 16, New York.

[fol. 56] *Duly sworn to by E. E. Bremner, jurat omitted in printing.*

Duly sworn to by David A. Berlin, jurat omitted in printing.

[fol. 57] Power of Attorney (omitted in printing).

[fol. 58] EXHIBIT A TO PETITION

Form 1231 (Rev. May 1955)

U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

APR 12 1957

(Seal of the
Treasury Dept.)

OFFICE OF
DISTRICT DIRECTOR OF INTERNAL REVENUE

IN REPLYING REFER TO:
UM:Au:R:EF:mw

(Seal)

Estate of A. Gourielli, Deceased
The Hanover Bank, Executor
70 Broadway
New York 4, New York
and
Mrs. Helena Gouriella, surviving wife
c/o David A. Berlin
1775 Broadway
New York 19, New York

Dear Sirs and Madam:

You are advised that the determination of the income tax liability of A. Gourielli, deceased, and Helena Gourielli, for the taxable year ended December 31, 1953, discloses a deficiency of $14,200.92 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, WASHINGTON 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the District Director of Internal Revenue, Audit Division, P.O. Box 1706, Grand Central Annex, New York 17, NY. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earliest.

Very truly yours,

Russell C. Harrington
Commissioner,

By /s/ KENNETH W. MOE
District Director of Internal Revenue.

Enclosures:
Statement
IRS Publication No. 160
Agreement Form

[fol. 59]

STATEMENT

Estate of A. Gourielli, Deceased
The Hanover Bank, Executor
70 Broadway
New York 4, New York
and
Helena Gourielli, surviving wife
c/o David A. Berlin
1775 Broadway
New York 19, New York

Tax Liability for the Taxable Year Ended

December 31, 1953

INCOME TAX

Deficiency $14,200.92

In making this determination of your income tax liability, careful consideration has been given to the report of ex-

amination, a copy of which was transmitted to you under date of December 4, 1956.

Adjustments to Net Income

Net income disclosed by return		$99,660.39
Unallowable deductions and additional income:		
(a) Dividend income	$ 2,977.50	
(b) Contributions	5,500.00	
(c) Travel and entertainment expense	2,500.00	
(d) Sales tax	300.00	
(e) Amortization premium on bonds	18,225.00	29,502.50
Total		$129,162.89
Nontaxable income and additional deduction:		
(f) Interest	1,666.30	
(g) Taxes	108.00	1,774.30
Net income adjusted		$127,388.59

Explanation of Adjustments

(a)-(d) incl. (f & g) These items have been previously explained and agreed to by you.

(a) This deduction claimed on your return for bond premium amortization has been disallowed to the extent shown inasmuch as it has not been substantiated as allowable under the provisions of the Internal Revenue Code.

[fol. 60]

TAXABLE YEAR ENDED DECEMBER 31, 1953

COMPUTATION OF TAX

Net income adjusted		$127,388.59
Less: Exemptions		1,800.00
Balance subject to tax		$125,588.59
Corrected income tax		$ 77,702.88
Less: Income tax payments to foreign countries		5,836.75
Corrected income tax liability		$ 71,866.13
Income tax liability disclosed by return	$50,390.55	
Add: Previously assessed 6	7,274.66	57,665.21
Deficiency in income tax		$ 14,200.92

[fol. 91] [File endorsement omitted]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 68443

ESTATE OF A. GOURIELLI, DECEASED, and HELENA GOURIELLI, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

STIPULATION OF FACTS—Filed May 20, 1959

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true, or to object to any fact herein stipulated on the grounds of immateriality or irrelevancy:

1. Petitioner Helena Gourielli is the surviving widow of A. Gourielli, deceased. The said A. Gourielli and Helena Gourielli were husband and wife during the taxable year 1953 and filed a joint Federal income tax return with the District Director of Internal Revenue for the Upper Manhattan District, New York. A copy of said joint return is attached hereto as Joint Exhibit 1-A.

2. A. Gourielli and Helena Gourielli, hereinafter referred to as petitioners, purchased Appalachian Electric Power Company, First Mortgage Bonds, 3¾%, 1981 Series, in the principal amount of $540,000 at a cost to said petitioners of $634,500 plus commissions of $1,350, and sold said bonds for $623,700 less commissions of $1,350, as set forth below:

[fol. 92]

Principal Amount	Date Purchased	Date Sold	Gross Sales Price	Cost	Commissions On Purchase	Commissions On Sale
$130,000	10/ 8/53	11/12/53	$150,150	$152,750	$ 325	$ 325
300,000	10/14/53	11/18/53	346,500	352,500	750	750
110,000	10/23/53	11/27/53	127,050	129,250	275	275
$540,000			$623,700	$634,500	$ 1,350	$ 1,350

3. The above-referred-to bonds were purchased by petitioners through the brokerage firm of Hirsch & Co., 25 Broad Street, New York, New York. The purchase price of the Appalachian 3¾% bonds, $634,500 plus commission of $1,350, was paid by petitioners in cash.

4. Attached hereto as Joint Exhibit 2-B is a copy of Mortgage and Deed of Trust of Appalachian Electric Power Company dated December 1, 1940, and as Exhibit 3-C, a copy of the Indenture Supplemental to said above-referred-to Mortgage and Deed of Trust dated as of June 1, 1951.

5. The Appalachian, 3¾% bonds were redeemable under the provisions of Joint Exhibits 2-B and 3-C on 30 days call notice prior to their fixed maturity date at either (1) a general redemption price from general funds, or (2) a special redemption price from certain specified funds.

6. The general redemption price specified with respect to said bonds was $1,053.75 (per $1,000 bond) if called during the twelve month period ending May 31, 1954. The special redemption price specified with respect to such bonds was $1,023.75 (per $1,000 bond) if called during the same period.

7. The petitioners made a due and timely election to amortize the premium paid on the above-described bond purchases. On their joint income tax return for the year 1953 the petitioners claimed a deduction of $83,056.07 as amortization of bond premium, representing the excess of the purchase cost, including commissions, of $635,850 over the special redemption price of $552,825 (540 X $1023.75).

[fol. 93] 8. The Commissioner allowed the deduction for amortization of the bond premium to the extent of $64,831.07 and disallowed the balance thereof amounting to $18,225.

9. For all years in which said Appalachian 3¾% bonds were redeemable with premiums, the regular redemption premium rate was in all cases higher than the special redemption premium.

10. The total aggregate amount of each Series of First Mortgage Bonds issued under the Mortgage and Deed of Trust (Exhibit 2-B) were:

% Series due	(December 1)	1970	issued	January	1941	$ 70,000,000
% Series due	(December 1)	1977	issued	January	1948	28,000,000
% Series due	(March 1)	1980	issued	April	1950	25,000,000
% Series due	(June 1)	1981	issued	July	1951	17,000,000
% Series due	(October 1)	1982	issued	November	1952	17,000,000
% Series due	(December 1)	1983	issued	January	1954	20,000,000
% Series due	(March 1)	1987	issued	April	1957	29,000,000
% Series due	(May 1)	1988	issued	June	1958	25,000,000
Total						$231,000,000

All of the foregoing First Mortgage Bonds are now outstanding in the same amounts in which they were originally issued; none of said Bonds is now or has ever been purchased, held or owned by Appalachian Power Company, and none of said Bonds has ever been called or redeemed by Appalachian Power Company.

At December 31, 1953, First Mortgage Bonds in the amount of $157,000,000 were outstanding. The 3½% Series due December 1, 1983 were issued in January, 1954.

11. There is attached and marked as Exhibit 4-D a schedule showing the amounts of property utilized and cash deposited with the Corporate Trustee by Appalachian Power Company under various sections of the Mortgage in order to satisfy certain requirements thereunder from 1941 to May 18, 1959, inclusive.

David Alter, Counsel for Petitioners.

Arch M. Cantrall, Chief Counsel, Internal Revenue Service.

[fol. 172]

33 T. C. No. 43

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 68443

ESTATE OF A. GOURIELLI, DECEASED, The Hanover Bank, Executor, and HELENA GOURIELLI, surviving wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Findings of Fact and Opinion—Filed and Served November 30, 1959

Bond Premium Amortization—Two Simultaneous Call Prices—Section 125.—The taxpayers have failed to show that the deduction for amortization of bond premiums should be the excess of the cost of the bonds over a "special redemption" price instead of the excess of cost over the "regular redemption" price, as allowed by the Commissioner.

David Alter, Esq., and Hubert Thurschwell, Esq., for the petitioners.

John J. Madden, Esq., and William F. Chapman, Esq., for the respondent.

The Commissioner determined a deficiency in income tax of $14,200.92 for 1953. The only issue for decision is whether the deduction for amortization of premiums on bonds under section 125(b) of the Internal Revenue Code of 1939 is limited to the excess of cost over the general [fol. 173] redemption rate of 105.375 as contended by the Commissioner or is the excess of cost over the special redemption rate of 102.375 as contended by the petitioners.

Findings of Fact.

A. Gourielli and Helena Gourielli were husband and wife during 1953 and filed a joint income tax return for that

year with the district director of internal revenue for the Upper Manhattan District of New York. The husband died before the filing of the petition and the wife survives.

Gourielli and his wife, hereafter referred to as petitioners, purchased Appalachian Electric Power Company (hereafter called Appalachian) first mortgage bonds 3¾ per cent, 1981 series (hereafter called the 1981 series) at 117½ and sold them at 115½ as shown in the following table:

Principal Amount	Date Purchased	Date Sold	Gross Sales Price	Cost	Commissions On Purchase	Commissions On Sale
130,000	10/ 8/53	11/12/53	$150,150	$152,750	$ 325	$ 325
300,000	10/14/53	11/18/53	346,500	352,500	750	750
110,000	10/23/53	11/27/53	127,050	129,250	275	275
540,000			$623,700	$634,500	$1,350	$1,350

The purchases were made through a broker. The purchase price was paid in cash.

The mortgage and deed of trust securing the Appalachian bonds, as amended in section 20C, contained, *inter alia*, provisions here summarized as follows:

The 1981 series, issued in denominations of $1,000, were to mature on June 1, 1981. Interest was payable on June 1 and December 1 of each year. The company, at its option or by operation of various provisions of the mortgage and deed of trust, could redeem 1981 series bonds at any time and from time to time upon notice published in a New York newspaper at least once in each of four consecutive calendar weeks, the first publication to be at least 30 days but not more than 90 days prior to the date fixed for redemption. The redemption would be at the principal amount thereof [fol. 174] and accrued interest to such date of redemption, together, if redeemed otherwise than by the use of cash deposited pursuant to sections 20 or 40 of the identure and otherwise than by the use of proceeds of released property or the proceeds of insurance, with a premium equal to a percentage of the principal amount thereof de-

termined as set forth in a schedule headed "Regular Redemption Premium", and if redeemed by the use of cash deposited pursuant to sections 20 or 40 of the indenture, by the use of proceeds of released property or the proceeds of insurance, with a premium equal to a percentage of the principal amount determined as set forth in the schedule under the heading "Special Redemption Premium."

The schedule referred to contains three columns. The left-hand one headed "Year" begins with 1952 and ends with the year 1979. The next column is headed "Regular Redemption Premium" and the right-hand column is headed "Special Redemption Premium." The following appears under those two columns: "(If redeemed prior to June 1 of the calendar year stated and subsequent to the last day of May of the calendar year next preceding such year)". Opposite each year a percentage is shown under each of the other two headings. Those shown under "Regular Redemption Premium" begin with 5¾ per cent and decline at the rate of ¼ per cent for some years and ⅛ for others until they reach ⅜ of 1 per cent for the year 1979. The percentages under "Special Redemption Premium" are 2⅜ per cent for the first 3 years, 2¼ per cent for the next 3 years, then decline ⅛ per cent at intervals until they get to be ⅜ of 1 per cent in 1979. The two columns are identical for the last 3 years, and below the schedule the following appears: "and without premium in either case if redeemed on or after June 1, 1979 and prior to maturity."

The petitioners elected to amortize the premiums paid on the bonds and claimed on their return for 1953 a deduction of $83,056.07 as amortization of those bond premiums based upon the "special" call price. The Commissioner allowed the deduction to the extent of $64,831.07 and disallowed $18,225 of the amount claimed.

The following table shows each series of Appalachian's first mortgage bonds, all issued under the same mortgage and deed of trust applicable to the bonds here in issue:

[fol. 175]

Interest Rate	Due		Issued		Total Amount
3¼%	December 1,	1970	January	1941	$ 70,000,000
3⅛%	December 1,	1977	January	1948	28,000,000
2⅞%	March 1,	1980	April	1950	25,000,000
3¼%	June 1,	1981	July	1951	17,000,000
3½%	October 1,	1982	November	1952	17,000,000
3½%	December 1,	1983	January	1954	20,000,000
4⅛%	March 1,	1987	April	1957	29,000,000
4 %	May 1,	1988	June	1958	25,000,000
				Total	$231,000,000

Appalachian has never called, redeemed or owned any of the above bonds, all of which are still outstanding in the amounts as originally issued.

The company had $1,685,114.65 available in 1953 for the call of 1981 series bonds at the "regular redemption" price, of which $1,359,155.02 was "actually certified in the year following the applicable year."

The prevailing rate of interest on bonds during 1952, 1953 and 1954 never fell below the prevailing rate for 1951.

No conditions existed in 1953 which would have warranted the calling of any Appalachian bonds. The business of the company was then expanding and its debt was increasing. The only fund which Appalachian could have used in 1953 to retire any part of the 1981 series at the "special redemption" price was "Releases (Cash) $42,626.30" which was withdrawn by the company on April 6, 1955. There was no likelihood that the debtor would consider redeeming any of the 1981 series during 1953.

All stipulated facts are incorporated herein by this reference.

[fol. 176] OPINION.

Murdock, *Judge*: Section 125 entitled "AMORTIZABLE BOND PREMIUM" allows deductions through amortization of premiums paid on bonds, the interest of which is wholly taxable. The amortizable premium here is the excess of

the cost over "the amount payable on maturity or on earlier call date", here on a call date long prior to maturity. The cost of these bonds subject to amortization is stipulated, the total cost of the bonds, including commissions paid at that time. The parties disagree only as to the amount by which these bonds can be amortized, the amount payable on a call date prior to maturity. They were actually sold at a profit since the basis was reduced by the amortization allowed, although they were sold for less than their original cost. The attraction presumably of the petitioners' investment in these Appalachian bonds was to obtain short-term capital gains to offset already realized short-term capital losses.

The question is—which of two redemption prices, each exercisable on the same call date, is to be used in computing a deduction for amortization of bond premiums. That question is not recognized or dealt with directly in section 125, its legislative history or the regulations. The Commissioner has allowed amortization of the bond premiums to the extent that the cost exceeds the "regular redemption" price. He not only does not argue that he was wrong in allowing that amount to be amortized but he affirmatively contends that the deduction of the excess of cost over the "regular redemption" price is proper. Cf. *Commissioner* v. *Korell*, 339 U.S. 619. He disallowed as a deduction the difference between the higher "regular" and the lower "special redemption" prices, and he contends that that disallowance was proper. However, he makes no argument in his briefs against the amortization of the [fol. 177] excess of the cost over the "special redemption" price that is persuasive or that would not apply as well to the amortization which he has allowed. The petitioners have failed to advance any adequate reason for amortizing the difference between cost and the "special redemption" price. In other words, neither party has supported its contention by a persuasive argument. The Tax Court has no justification for changing the Commissioner's determination since it is presumed to be correct and the burden of proving otherwise is upon the petitioners.

The Court is not persuaded that these petitioners, who held these bonds for only 35 days, are entitled under this regulation to deduct the difference between cost and the "special redemption" price.[1] In fact, the record shows that except for an unsubstantial portion, the bonds could not have been redeemed at the "special redemption" price at any time while petitioners owned them. The presumption of correctness attaching to the determination of the Commissioner is not a very satisfactory basis on which to rest a decision, but there is nothing factually or legally beneficial to petitioners in this case upon which a decision in their favor can be rendered.

Decision will be entered for the respondent.

[fol. 190]

BEFORE THE TAX COURT OF THE UNITED STATES
WASHINGTON

Docket No. 68443

ESTATE OF A. GOURIELLI, DECEASED, The Hanover Bank, Executor, and HELENA GOURIELLI, surviving wife, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—Entered December 31, 1959

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed November 30, 1959, it is

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[1] Section 125 seems to make available a tax advantage through long-term capital gains and the benefit demonstrated by the present case of offsetting capital losses, although neither possibility is mentioned in the legislative history or in the Regulations. See, in this connection, Regs. 118, section 39.125(b)-2.

Ordered and Decided: That there is a deficiency in income tax of $14,200.92 for the year 1953.

J. E. Murdock, Judge.

Served January 4, 1960

[fol. 193] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

T.C. Docket No. 68443

ESTATE OF A. GOURIELLI, DECEASED, THE HANOVER BANK, EXECUTOR, and HELENA GOURIELLI, SURVIVING WIFE, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION FOR REVIEW—Filed March 30, 1960 in the Tax Court of the United States

Taxpayers, the petitioners in this cause, by David Alter, Counsel, hereby file their petition for a review by the United States Court of Appeals for the Second Circuit of the decision by the Tax Court of the United States entered December 31, 1959, pursuant to Findings of Fact and Opinion, 33 T.C. ——— No. 43, finding a deficiency in the petitioners' Federal income taxes for the calendar year 1953 in the amount of $14,200.92, and respectfully show:

I

Petitioner Helena Gourielli is the surviving widow of A. Gourielli, deceased. The said A. Gourielli and Helena Gourielli were husband and wife during the taxable year 1953 and filed a joint Federal income tax return with the

[fol. 194] District Director of Internal Revenue for the Upper Manhattan District, New York.

II

Nature of Controversy

The sole question presented in this cause is whether petitioners correctly determined the amount of amortizable bond premium on Appalachian Electric Power Company First Mortgage Bonds, 3¾%, 1981 Series, with reference to the special redemption price of $1,023.75 per $1,000 bond.

Under the provisions of a Mortgage and Deed of Trust dated December 1, 1940 and of the Indenture Supplemental to said Mortgage and Deed of Trust dated as of June 1, 1951, the said bonds were redeemable on 30 days call notice prior to their fixed maturity date at either (1) a general redemption price from general funds, or (2) a special redemption price from certain specified funds.

The general redemption price specified with respect to said bonds was $1,053.75 (per $1,000 bond) if called during the twelve month period ending May 31, 1954. The special redemption price specified with respect to such bonds was $1,023.75 (per $1,000 bond) if called during the same period.

[fol. 195] The petitioners made a due and timely election to amortize the premium paid on their purchases of such bonds during the calendar year 1953. On their joint income tax return for such year the petitioners claimed a deduction of $83,056.07 as amortization of bond premium, representing the excess of the purchase cost, including commissions, of $635, 850 over the special redemption price of $552,825 (540 × $1023.75).

The Commissioner allowed the deduction for amortization of bond premium to the extent of $64,831.07 and disallowed the balance thereof amounting to $18,225, determining a deficiency for the year 1953 in the amount of $14,200.92. The decision of the Tax Court entered Decem-

ber 31, 1959 sustains the Commissioner's determination as aforesaid.

III

The said petitioners being aggrieved by the Findings of Fact and Opinion of the Tax Court, 33 TC ——— No. 43, and by its decision entered pursuant thereto, desire to obtain a review thereof by the United States Court of Appeals for the Second Circuit.

David Alter, Counsel for Petitioners, 32 East 57th Street, New York 22, N.Y.

[fol. 196] *Duly sworn to by David Alter, jurat omitted in printing.*

[fol. A]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 66899

JACOB A. GOLDFARB and BERTHA L. GOLDFARB,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances

For Petitioners: Karl W. Windhorst, Esq.

For Respondent:

DOCKET ENTRIES

1957

Apr 26—Petition received and filed. Taxpayer notified. Fee paid.

May 15—Copy of petition served on General Counsel.

Apr 26—Request for Circuit hearing in N.Y., N.Y. filed by petr. 5/14/57, granted. Served 5/15/57.

Jun 19—Answer filed by Resp. Served 6/21/57.

1959

Feb 2—Notice of trial at New York, N.Y. April 20, 1959. Served 2/2/59.

Apr 22—Trial before Judge Mulroney—N.Y., N.Y. Stip of facts with exs. 1-A, 2-B, 3-C, 4-D, E, F, 7-G H, 9-I, 10-J, filed. Briefs due June 22, 1959; reply briefs due July 22, 1959.

Jun 4—Transcript of Proceedings 4/22/59, filed.

Jun 19—Joint motion for extension of time to July 22, 1959, to file briefs. Granted 6/22/59. Served 6/22/59.

1959

Jul 14—Motion by petrs. for extension of time to August 7, 1959, to file brief. Gr. 7/15/59. Served 7/15/59.

Jul 22—Resp. Brief filed.) Served 8/10/59.

Aug 7—Petrs. Brief filed.)

Aug 21—Motion by resp. for extension of time to Sept. 30, 1959, to file reply brief. Granted 8/25/59. Served 8/26/59.

Sep 3—Motion by petr. for extension of time to Sept. 30, 1959, to file reply brief. Granted 9/8/59. Served 9/10/59.

Sep 30—Reply Brief filed.)

Sep 30—Reply Brief filed.) Served 10/1/59.

Dec 24—Findings of Fact and opinion filed, Judge Mulroney. Served 12/24/59.

Dec 28—Decision entered, Judge Mulroney. Served 12/30/59.

1960

Mar 23—Petition for review by U.S. Ct. of Ap. 2nd Cir. filed by petrs.

Mar 23—Proof of service filed.

[fol. B]

Apr 28—Order extending time for filing record on rev. and docketing pet. for rev. to June 21, 1960. Served 4/28/60.

May 9—Motion by resp. on rev., consented to by petrs. on rev., for retention of exhibits until 10 days before argument, filed.

May 9—Order directing retention of original exhibits until 10 days before argument.

[fol. 1]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 66899

JACOB A. GOLDFARB and BERTHA L. GOLDFARB, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondents.

Room 5050,
Grand Central Terminal Bldg.,
70 East 45th Street,
New York, New York.

Transcript of Testimony—Wednesday, April 22, 1959

Met, pursuant to notice, at one o'clock p.m.

BEFORE:

Hon. John E. Mulroney, Judge.

APPEARANCES:

Karl W. Windhorst, Esq., 125 Park Avenue, New York, N.Y., appearing on behalf of the petitioner.

Victor H. Frank, Jr., 90 Church Street, New York 7, N.Y., appearing on behalf of respondent.

[fol. 3]

Proceedings

The Clerk: Docket No. 66899, Jacob A. Goldfarb.

Mr. Windhorst: Karl W. Windhorst, for the petitioner.

Mr. Frank: Victor H. Frank, Jr., appearing on behalf of the respondent.

OPENING STATEMENT ON BEHALF OF PETITIONER

By Mr. Windhorst:

Mr. Windhorst: May it please the Court, this case, being Docket No. 66899, involves a deficiency in income tax in the amount of $14,708.16 for the calendar year 1953.

The issue, simply stated, is whether the petitioners in determining the amount of amortizable bond premium under Section 125 of the 1939 Internal Revenue Code, which may be claimed as a tax deduction, were entitled to use the difference between the cost of the bonds and the amount payable if the bonds had been called at the special redemption price.

The petitioners in their tax return for the calendar year 1953 claimed a deduction for amortizable bond premium in the amount of $47,170, with respect to certain Arkansas Power & Light bonds in the face amount of $500,000.

These bonds were purchased by the petitioner, Jacob A. Goldfarb, in November, 1953, at a total cost of $553,975. The bonds were subject to call either at a special redemp- [fol. 4] tion price or at the general redemption price. The special redemption price was somewhat lower than the general redemption price.

The petitioners, in determining the amount of amortizable bond premium which was claimed as a deduction on their tax return by computing the difference between the total cost of the bonds amounting to $553,975 and the special redemption price of $506,800, which would have been payable if the bonds had been called at the special redemption price.

As I have previously mentioned, this difference amounted to $47,175, which was claimed as a tax deduction.

The Commissioner, in his 90-Day Letter, disallows 20,000 of the $47,175 which have been claimed as a tax deduction. The amount of this partial disallowance represents the excess of the general redemption price over the special redemption price.

By making a partial disallowance, the Commissioner has recognized that the petitioners are entitled to a deduction for amortizable bond premium, but he determined it with reference to the general call price in lieu of the special call

price, as the petitioners determined the amount of the amortizable bond premium.

It is the position of the petitioners that the Commissioner's action is wholly without merit, being contrary both to the statute and to the regulations. The identical issue [fol. 5] which is involved here was recently decided in favor of the taxpayer by a District Court in Tennessee. The name and citation of this case is Parnell versus 59-1 U.S.T.C., paragraph 9224, and that opinion was rendered on October—

The Court: Do you have the Federal citation?

Mr. Windhorst: No, I don't think it has been decided. The opinion was rendered on October 29, 1958, so the Federal Supplement citation hasn't come out as yet.

The parties have entered into a fairly complete stipulation of facts, which will be filed with your Honor. The stipulation contains quite a few paragraphs which were inserted or included in the stipulation at the request of Government counsel. We believe that many of these paragraphs are wholly immaterial and irrelevant to the issue here, and so we have noted a separate objection to the various paragraphs that we have taken exception to.

I don't know the number of paragraphs, but it may run as high as 15 paragraphs that we have objected to. I don't suppose your Honor would care to hear any argument on that point because it can be taken care of on brief.

The Court: I think you can develop that better on brief.

Mr. Windhorst: We believe the issue here is primarily a legal one. Section 125 of the 1939 Code provides that amortizable bond premium is to be determined by reference [fol. 6] to the amount payable on maturity or on earlier call date, based upon the statutory language as well as the regulations that the petitioners correctly determined the amount of amortizable bond premium by using the special redemption price.

Opening Statement on Behalf of Respondent

By Mr. Frank:

Mr. Frank: May it please the Court, I would like to state the facts a little differently in the hope that it might clarify the air somewhat.

Petitioner purchased half a million dollars worth of face value, Arkansas Power & Light, four and a quarter bonds, in November of 1953. The average price he paid was somewhat around $110 for these $100 face value bonds. Actually, I am using the figure $100; the denomination was $1,000 terms, but for our purpose it is clearer to talk in terms of $100 and $110 prices.

He purchased those bonds in November of 1953, and in that year he took a deduction based on a principle which I will discuss subsequently. Those bonds were sold some seven months later, in 1954, at around $105. Those bonds were redeemable at two prices, according to the Deed of Trust and the supplemental indentures thereto. They were redeemable at a general call price and a special call price during the period involved for our purposes; the general call price was $105 and the special call price was $101.

[fol. 7] What the taxpayer wants to do is to take a deduction of nine points between the difference from $110 and $101. The Commissioner's position is that it is limited to a five point deduction. Those facts are somewhat oversimplified for the purposes of presentation, but substantially, those are the facts.

Respondent's position for his disallowance is mainly based on two grounds. The first ground is that there was no day certain for the redemption at the special price and the fact that a day certain is required is set forth in Regulation 118, issued under Section 125 of the Internal Revenue Code of 1939.

There is not a day certain specified in the certificate of the bond. If you look behind the bond at the Deed of Trust and the supplemental indentures, they do not suggest any particular day certain, and the facts in the matter do not indicate that there is any day certain.

These bonds could have been redeemed at the special price only from one of four sources, and those sources are as follows: A Maintenance and Replacement Fund, into which the corporation had the option of placing either cash or property additions or any other alternative to cash. They were redeemable from a fund called a Released Property Fund, if there was any cash available in it. They were

redeemable from an Eminent Domain Fund, if there was [fol. 8] any cash available in that fund, and petitioner claims and respondent disputes that they were redeemable in the time herein material from the Sinking and Improvement Fund for the four and a quarter bonds.

The facts indicate that no cash was ever placed in any of those funds, and the bonds could be redeemable at the special price only if there was cash in any one of those particular four funds.

The facts also indicate that none of those bonds, none of the Arkansas Power & Light bonds, were ever redeemed at any prices with the exception of this particular issue, which was redeemed in 1955 at the general call price; that is, 105.

Further, the facts indicate that this was the type of company that was an expanding utility that needed all the cash it could obtain to expand to cover their particular property additions to help them in their progress, and it was silly for the company to go out and borrow on the bond market money at the same time that they had this money available, so what they naturally would do would certify property additions to the funds; they were required to certify property additions and use their cash for their expansion program.

We submit that there was nothing certain about this date for a special redemption because on the face of the bonds it is not indicated, because if you refer to the sup [fol. 9] plemental indentures and the Deed of Trust you will find it could only be redeemed from one of those four funds into which no cash was ever placed, and into which the history of the company indicated no cash would ever be placed, and consequently it was conjectural, it was uncertain, and there was no definite time ever specified for the redemption of those bonds at the special call price.

Respondent's second reason for disallowing what amounts to the five dollar difference is that the premium was due to an alleged tax aspect. The committee reports under Section 125, we believe, made it amply clear that the bond premium will be allowed to be amortized only in the case where that bond premium is due to a higher interest rate paid on the particular bond, and in this particular instance,

what we have is a bond premium which was beefed up—if I may use that term—by the rumor that this was a good tax deduction bond, it had a tax gimmick aspect to it.

We believe the premium was not based on any—was not based entirely on any higher interest rate, but was based to the larger part upon this tax gimmick. As further evidence of the fact that those bonds were bought not primarily for yield or interest, but primarily for this tax reason, is the whole pattern and atmosphere of this transaction, the fact that Mr. Goldfarb, the active petitioner, bought half a million dollars face value bonds and that he [fol. 10] borrowed within twenty or thirty thousand dollars the amount of money to cover this purchase, the fact that he ends up with a net yield of maybe a quarter of one percent, the fact that in the subsequent year he did the same thing, the fact that if he wanted to buy for a good yield he would have bought tax exempts being in his tax bracket, and the fact that he bought them in November, just a little over thirty days before the year elapsed, so that he could take a deduction or have some claim of a deduction in 1953, and sold them some seven months later, just six months after the capital gains tax would go into effect for his purposes.

If your Honor please, in regard to the Parnell case, the Solicitor General has already authorized an appeal. We believe the facts are different in the Parnell case from this case in that in our case the bonds were redeemed at the general redemption price in 1955, the bonds were never redeemed in the Parnell case.

Secondly, that the Parnell case did not consider the facts which we believe will be presented here today; and thirdly, with all due respect to the District Court in that case, we believe that their treatment of the Regulation 118 under Section 125 was somewhat cavalier.

Now, the petitioners have injected into the stipulation of facts their objection on the basis of immateriality and irrelevancy. We would prefer to have a ruling from the [fol. 11] Bench during the course of this trial that those facts are material and are relevant for the basic reasons we have just discussed; the primary facts which were objected to were mainly those dealing with the financing

of those bonds, the borrowing from the particular banks to purchase the bonds, and the fact that as a matter of actual practice, the company never placed cash in any of the funds in which they were obligated to place cash or the property additions or some alternative to cash, so we would not ask at this moment for a ruling but we would like a ruling at some point in the course of the trail on those particular objections.

Lastly, respondent would like to place in evidence the 1954 tax return of the petitioners, which we believe indicates the pattern, the tax pattern involved, which we believe supports our view that the premium was due to this tax pattern and consequently not within the intendment of Section 125.

I believe there is no objection to the fact that this is the actual tax return. I believe that petitioners may have an objection to the introduction in evidence of this 1954 tax return, but respondent would like to submit in evidence—

The Court: Have you a stipulation—is that all you have to say with respect to the opening statement?

Mr. Frank: Yes, your Honor.

[fol. 12] The Court: You have a stipulation to present?

Mr. Frank: Yes, we have a stipulation, with Exhibits GG up to 10-J. Exhibits 1-A, 2-B, 3-C, 4-D, Exhibit E, Exhibit F, Exhibit 7-G, Exhibit H, Exhibit 9-I, and Exhibit 10-J.

The Court: The stipulation, with the exhibits attached, will be received.

(Whereupon the documents referred to as Stipulation, with Exhibits GG up to 10-J, Exhibits 1-A, 2-B, 3-C, 4-D, Exhibits E, F, 7-G, H, 9-I and 10-J were received in evidence.)

Mr. Frank: Respondent would now like to present in evidence as Exhibit K the individual income tax return of the petitioners for the year 1954.

Mr. Windhorst: Your Honor, petitioners object to the introduction of petitioners' Federal income tax return for the year 1954 for several reasons. This case here involves 1953. Any transaction reported in 1954 had absolutely no

bearing on this particular case. We are not involved with determining the liability for 1954. Whatever facts are in that return, I don't see how it can be material or relevant to the issue in this particular case. We do not involve any transactions except that the gain which was reported on the sale of those particular bonds involved in the year '53, as far as any other transactions which we might have noted in there. I don't see how that possibly could affect [fol. 13] this case.

So we strenuously object to the respondent's offering this 1954 tax return into evidence at this time.

The Court: On this stipulation, you have noted objections to a number of paragraphs.

Mr. Windhorst: Yes.

The Court: What paragraphs?

Mr. Windhorst: Paragraph 2, we note an objection as to the method he had paid for the bonds. Respondent, by allowing the deduction down to the general call price, has admitted ownership of the bonds. There cannot be any question as to that, and we don't see how or why the method of financing those bonds has any part in this case.

The Court: Well, I am only going to get your grounds, the same as the others.

Mr. Windhorst: Yes, I think the next paragraph is paragraph 9, paragraph 10, paragraph 11, paragraph 12, paragraph 13, 14, 15, 18—

Mr. Frank: If I may interject, the reason for this objection changes around paragraph 13.

Mr. Windhorst: His Honor just asked the paragraphs.

The Court: Materiality and relevancy—

Mr. Windhorst: Same ground.

The Court: I don't see any change.

Mr. Frank: But the substance of the paragraphs from [fol. 14] here on no longer deal with financing.

Mr. Windhorst: That is true.

The Court: Go on, then.

Mr. Windhorst: Then there is 18, 19, 20, 21, 22, 23, 24, 27, 28, 30.

The Court: All of those objections, including the objections to the 1954 income tax return are on the grounds of irrelevancy and immateriality.

I might state that whenever this objection is made in a case, which is to a large extent a stipulated case, and I might also say it is in a territory area that I am not at all familiar with, no such issue has ever been presented before—I am not familiar with the statute—I am going to overrule the objection and at this time you can develop it on brief, but the evidence—I want it in there if it is going to be used as a basis for any theory that is going to be developed on brief; the evidence has to be in there in order to develop it, so the ruling of the Court will be that the objection is overruled, and the exhibit—which is the 1954 income tax—will be marked Exhibit K—

Mr. Windhorst: Before you rule on the '54 tax return, could I have counsel for respondent just state the specific purpose for which that is being offered? I don't think he actually was too specific as to the purpose for which it was being offered.

[fol. 15] Mr. Frank: I believe I did state that the tax return does indicate the pattern used by this taxpayer; that it indicates that he bought those bonds for a tax purpose which indicates that the premium of the bonds was to a substantial degree influenced by the tax aspect which was thought to be accorded to such bonds.

Mr. Windhorst: Is your only purpose to show he reported a capital gain on the sale of the Arkansas bonds?

Mr. Frank: No, sir.

Mr. Windhorst: What other purpose do you have in mind?

Mr. Frank: We believe the tax return shows a pattern, it shows the acquisition of four other bonds, it shows the deductions as amortization of a certain amount and the reporting of interest of a certain amount from those four bonds. It indicates, also, the date on which the Arkansas four and a quarters were sold, and all of those things reflect upon the premium of bonds to tax purposes.

The Court: To the extent it is useful to develop the theory that the respondent has in the determination of this deficiency, it is admitted; if that theory be a correct theory on which a determination should be made, that is another question. It is a question of law.

Exhibit 10 is admitted.

The Clerk: I believe that would be Exhibit K, your [fol. 16] Honor.

(Whereupon the document referred to as Respondent's Exhibit K was admitted in evidence.)

The Court: Call your witness.

Mr. Windhorst: Petitioners will rest for their case in chief with a reservation that we may call a witness on rebuttal.

Mr. Frank: Is respondent to understand that the witness will be called solely for the purposes of rebuttal?

Mr. Windhorst: Yes.

Mr. Frank: Respondent calls Mr. Richard Beuchler.

Richard Beuchler a witness called by and on behalf of respondent, being duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Richard Beuchler, 785 Park Avenue, New York City.

The Clerk: Thank you.

Direct examination.

By Mr. Frank:

Q. What is your present position?

A. I am manager of the Bond Department of E. F. Hutton & Company.

Q. For the benefit of the record, would you describe E. F. Hutton?

[fol. 17] A. Well, we are one of the large stock exchange firms and the department I manage is active in the underwriting and trading of both corporate and municipal bonds.

Q. Are you a national office?

A. We have 35 offices from coast to coast, and I would say probably among half a dozen of the largest firms in the country.

Q. How long have you been in the bond business, if I might ask?

A. 35 years.

Q. Were you with E. F. Hutton at all times during this 35 years?

A. No, I went over there in January, '58, to organize a Bond Department for them. Previous to that, I managed a Corporate Bond Department for Lehman Brothers.

Q. Would you describe Lehman Brothers for the benefit of the record?

A. They are one of the largest underwriting houses in the country and there my job was on the Price Committee on new bond issues as well as running a trading department in corporate bonds.

Q. I take it, then, you are familiar with the pricing of bonds in general?

A. I am.

Q. That includes public utility bonds?

A. We bid every week on probably three or four new [fol. 18] issues that come up.

Q. Are you familiar with the redemptions of various public utility bonds?

A. I am.

Q. If a public utility bond has a call price in it, does it sell at that price or below that price or above that price?

A. Well, that depends upon money market conditions at the time. Usually, when it is brought out, it sells at least four or five points below the call price because buyers wouldn't buy it unless there was some protection against a call, but when money rates fluctuate as they have very much so in the last half a dozen years, dependent upon the policy of the Federal Reserve System, then the bonds may go up or down from that price.

We get a lot of bonds of that type that sell in the 80's or 90's, and some bonds with high coupons are still above par.

Q. When you speak of call price, are you interpreting that to be the general call price?

A. Well, from a practical standpoint, we find that is the only call price that means anything.

Q. Suppose it has what is known as a special call price in it, in the bond. How does that affect the price paid for the bond by and large?

[fol. 19] A. That special price that you refer to which we call the sinking fund call price, is usually not more than one thirtieth—let me correct that—if it is a 30-year bond, the provision for Sinking Fund in a utility bond is usually one percent that can be called a year—that would mean over 30 years that you could call 30 percent of the issue. I don't recall any public utility bonds that have been called at their sinking fund price.

In other words, if they call the whole lot, they have to pay the general call price because they have no right to call more than one percent during the calendar year, with certain exceptions.

Q. Let me ask you this, are you familiar with the Arkansas Power & Light four and a quarter bonds?

A. I am.

Q. When were you originally familiar with those bonds?

A. Well, I think they came out in 1953, if my recollection holds, and subsequently they sold up along with a lot of "A" utility bonds in which there was a lot of what I might call speculative activity at that time.

Q. You knew about those bonds before I consulted you about the nature of those bonds?

A. Yes, because that was one of the new issues in which we bid at the time.

Q. You mentioned "A" utility. What does "A" utility [fol. 20] mean?

A. That is a rating given by Moody's Investment Service. Bonds are rated "AAA" the highest grade, "AA" prime, and "A" a good upper middle-grade bond.

Q. Was part of the premium which was paid for the Arkansas four and a quarter bonds due to an alleged tax deduction on those bonds?

Mr. Windhorst: I object, your Honor. This is certainly outside the field of his qualifications as an expert in the corporate bond field.

The Court: Overruled.

The Witness: Would you repeat the question, please?

By Mr. Frank:

Q. Yes, you testified you were familiar with the Arkansas Power & Light four and a quarter bonds, and that they

sold up—I think those were your terms—was the fact that they sold up or a premium was paid for those bonds, was that attributable to an alleged tax deduction? Can you answer that question?

Mr. Windhorst: I object again. I don't think this is within the witness's knowledge.

The Court: He may answer if he can. I don't understand the question too well, but maybe your answer would clear it up.

The Witness: Let me put it this way: There were maybe [fol. 21] a dozen of "A" type utility bonds that were active at that time, such as Arkansas Power & Light, four and a quarter,—Appalachian Electric, three and three quarters was another—in which people were buying upon the theory of writing off the bond down to the general call price.

My strong recollection is that anybody who asked us, we advised them to write it down. I find a S. I. Electric Company—they are the leading bond brokerage firm in Wall Street—their suggestion was also to me that probably the best way to do was to write it down to the general call price if we did any of that business.

So, what business we did, we advised customers that way. That was simply an opinion that we had. However, there were a lot of other bonds of that type which were written down to the call price for the purpose of taking a short term loss with the hope, I believe, that the bonds would hold at that level for six months or so, when a long-term profit could be taken at the 25 percent rate.

We did not do a great deal of that. I would say principally because it wasn't the type of business that we were doing primarily.

Q. Was someone promoting those bonds, those type of bonds like the four and a quarter Arkansas bonds—were they promoted?

A. I wouldn't use the word promotion. I would say that [fol. 22] some brokers were probably recommending it on the feeling that there was a profit to be made on the transaction this way. That is a matter of opinion, that is all.

The Court: What are you trying to bring out in this testimony?

Mr. Frank: We are establishing that the premium was in part due not to its interest rate but to the fact that those bonds were being sold as for want of a better term, tax gimmick bonds, and that if the premium exists for those reasons—

The Court: That would be the subject of expert testimony.

Mr. Frank: I believe it is. The way we can establish that the price of those bonds was influenced by the tax gimmick is only through an expert.

The Court: It doesn't strike the Court that that would ever be the subject of expert testimony. I take it that Mr. Beuchler isn't an expert on taxation gimmicks—

Mr. Frank: But he is an expert on what the price of bonds is.

The Court: He could give us the price of those bonds or what he thinks would be the price of those bonds— It seems to me we are going far afield of what various bond houses thought with respect to them.

Bring it out rather briefly with the price of those bonds, and if there is wrapped up in that price some tax ad- [fol. 23] vantage, he can so state in his opinion that that is in it. That seems to me about all that a witness could testify that would be at all helpful to the Court.

Mr. Frank: That is specifically what we had in mind.

By Mr. Frank:

Q. Mr. Beuchler, was the fact that those bonds were selling at a premium due solely to the—

The Court: Has he said they were selling at a premium?

Mr. Frank: Yes, he said they sold up to—I am not sure exactly, he said they sold up to 100 or so, I believe.

Mr. Windhorst: I don't believe he has laid sufficient foundation for him to testify to that.

Mr. Frank: We will bring everything out.

The Court: Let him testify and not have it questioning any of the facts.

By Mr. Frank:

Q. Mr. Beuchler, what were the Arkansas four and a quarter bonds selling for in 1953, if you know?

A. You mean, in November?

Q. Any time during 1953, but specifically, addressing your answer to November, 1953.

A. My recollection is that they were selling around [fol. 24] 110 at that time.

Q. Why were they selling that high?

A. Well, I looked through my files to find out what kind of a yield other "A" type of bonds were selling at that time. Long Island Lighting Company, for example, an "A" bond—

The Court: We are going far afield again. Can you tell why they were selling that high without—

The Witness: There are two reasons, your Honor, that I can see why they were selling that high. They were selling on a 370 basis when other "A" bonds were selling at 345 to 350 basis, new issues, because either buyers thought they were getting a better rate of return on their money and were willing to take the change of a five point premium above the call price that they would not be called and get 20 points basis extra for that risk, or they believed that there was a tax advantage in buying those and writing down the call price as was done in a lot of "A" type of bonds at the time.

Q. Did the second factor that you mentioned, the tax factor, was that more of an influence than the first factor, in your opinion?

A. I would say—

Mr. Windhorst: I object. I don't think this man is qualified to answer that question.

The Court: Let him answer. We are just going to get [fol. 25] his opinion.

A. I would say that is a difficult question to answer. I believe that the price of most "A" bonds, particularly Appalachian Electric three and three quarters—

The Court: We are not interested in those bonds. We are only trying to get the reason for the price for those bonds.

The Witness: I believe that the price reflected in part the tax advantage to writing them down to call with the belief that on a 370 basis, they might hold that level long enough to enable that person to take a long-term capital gain.

By Mr. Frank:

Q. Let me just ask this question by way of indicating your familiarity, if you do have it, with the price market for bonds. Do you follow the price market of bonds daily or weekly or how often do you follow the price market for bonds?

A. I should say during the entire trading day, from nine thirty to four.

Q. You mentioned a 370 write out yield. Would you explain for the purposes of the record what you mean by yield?

A. Well, that is the yield of maturity, this was a four and a quarter percent bond due in 1983, and it would yield the buyer, because of its premium, only 3.70 percent at the ten point premium at which it was then selling.

[fol. 26] Q. Yield is a little different than interest rate, then, is that correct?

A. Right.

Q. What was the prevailing interest rate in or about November, 1953?

A. About 345 to 350 percent in "A" utilities bonds.

Q. How do you know that?

A. I looked up our records as to some of the issues we underwrote and I found on Long Island Lighting, Monongahela Power, one came November 9th, one came December 1st. They came to that yield and Appalachian Electric bonds, which came a month later, when the market was still a little better, came on a 335 yield.

Q. Were interest rates declining toward the end of 1953?

A. Yes, particularly all during 1953, interest rates were going down to—going down due to the Federal Reserve's money policy at that time.

Q. Did they continue declining in '54?

A. Yes.

Q. The middle of '54?

A. They declined during '54 and part of '55. As I recall, the trend did not reverse itself until '56.

Q. You testified, I believe, that it was unlikely that a public utility would redeem its bonds from its sinking [fol. 27] fund at the special call price, is that correct?

A. That is right.

Q. Would your answer be different if the company could also redeem at the special call price from its maintenance and replacement fund?

A. Most of the maintenance and replacement funds are not cash sinking funds but are property addition funds.

Q. Do you mean by that that they have the option or they are mandatory?

A. They have the option of putting property additions instead of cash into the fund. Some companies, Wisconsin Power & Light, for example, have a cash sinking fund only, but that is only one percent a year for the 30 years in which the bonds are outstanding.

Q. Your answer would not be different if they were callable at the special price from the maintenance and replacement price, is that correct?

A. That is correct, if I understand your question.

Q. Would your answer be different if they were also callable at the special price from a released property fund?

A. No, my answer is based on the fact that it is only one percent a year and whether it is from property funds or cash funds, I don't see how you are going to call 100 percent of an issue at sinking fund call price.

Q. In other words, to your knowledge, public utility bonds [fol. 28] are not redeemed at the special call price regardless of what funds they are redeemable from, is that right?

A. That is right.

Mr. Windhorst: I object to that question. I don't think this man knows.

The Court: It is as to his opinion, not as to his knowledge.

Mr. Frank: That is correct.

The Witness: Well, I can say that looking back over a period of 20 years, I can't recall a single bond that was called at sinking fund call prices in the utility field.

By Mr. Frank:

Q. Do public utilities usually place cash in their funds which are available to retire bonds?

A. Some of them do have a cash sinking fund, and they are more apt to exercise that if the bonds were at a discount and make money by buying them in, than if the bonds were at a premium.

Q. You said some of them do. Which ones usually place cash, to your knowledge, in their various funds?

Mr. Windhorst: I object. This man can't possibly have any knowledge of that. That is not expert testimony.

Mr. Frank: He deals in the bond market.

The Court: He might. If he has knowledge, he can answer.

[fol. 29] The Witness: Well, Hiatus Company—

The Court: You weren't asked to name the company. Are there various kinds of companies that have this cash in the sinking fund?

Mr. Frank: Could you read the question back from the record?

(Question read.)

The Court: I thought you meant which kind. You are not going to have him name all the companies?

Mr. Frank: No, just whatever he knows.

The Court: What do you mean by which ones?

Mr. Frank: Which type of company.

The Witness: Some electric utility companies do and some don't. The only answer is specific companies.

The Court: You can't answer as to types?

The Witness: No. There is no difference in type.

By Mr. Frank:

Q. Is that dependent on whether the bond and indenture requires them to put cash or gives them the option?

A. That is right.

Q. What do you mean by that?

A. Yes, some indentures of utility companies expressly state that the company must apply a one percent sinking fund. It is seldom any larger. I think there occasionally is one and a half; natural gas companies have larger sink-
[fol. 30] ing funds, but we are dealing with electric utilities and I don't recall any that have a larger sinking fund than one and a half percent at the most.

Q. But the question I am asking you is this: Is it true that some companies have a requirement that only cash be placed in a sinking fund?

A. Yes.

Q. Is this—

The Court: What you are asking is that a company that is required to place cash in its sinking fund does—

Mr. Frank: That is right, and there is a distinction between the type of indenture which gives the company the option and the type which requires the company to place cash in its sinking fund, and it is only likely that the special price would be exercised in the case where the company is required to place cash in their sinking fund, but this is the type of information that an expert knows about, and this, in our belief, is the only way we can get this into evidence.

By Mr. Frank:

Q. Is it mandatory that some companies place cash in their maintenance and replacement fund, in your knowledge, if you have knowledge to this extent?

A. I am not sure on that provision. I am only sure on what we call the cash sinking fund or property addition sinking fund, not on the maintenance question.

[fol. 31] Arkansas Power & Light Company was part of the Middle South Utilities Company, holding company, and most of the companies in that group use property additions rather than cash.

Q. Was it reasonable to expect that the special call price would be exercised in the Arkansas four and a quarter bonds, to your knowledge?

Mr. Windhorst: I object. This man couldn't possibly answer that question even if he is an expert in the corporate bond field.

The Court: He might have some knowledge.

The Witness: I believe I could answer that question very easily. From the standpoint of experience I have never seen a utility called in whole at the sinking fund call price.

Q. Was it reasonable to expect that the sinking call price in these Arkansas four and a quarter bonds would be exercised?

A. No.

Q. I take it that it is some concern of yours as a Bond Department to advise your clients who are purchasing those bonds as to whether there is a chance they will be redeemed at a special call price, is that right?

A. Well, let me say that a good part of our business is with institutions who are familiar with those things, and [fol. 32] we furnish them with a prospectus when they buy them, and it is not necessary to give them a great deal of additional information.

Q. Was Arkansas Power & Light an expanding utility, do you know?

A. Yes, it was and it is. They are going to sell some preferred stock within the next month for expansion purposes.

Q. Do companies ever desire—does a company like Arkansas Power & Light ever desire to refund a whole issue?

A. Only when they think they can save money by selling a new issue at a cheaper price, not to reduce the debt.

As a matter of fact, Arkansas Power & Light did refund those bonds in 1955 through the sale of three and three-eighths percent bonds.

Q. Would you advise a high income tax bracket person to buy this type of bond for yield?

Mr. Windhorst: I object again, your Honor, that this is outside the qualification of this man.

The Court: Sustained.

By Mr. Frank:

Q. Is the Arkansas four and a quarter bond an investment grade bond?

[fol. 33] A. Yes.

Q. When you say—what does investment grade bond mean in that case?

A. Where you have a reasonable assurance that principal will be paid at maturity and interest will be paid regularly.

Q. Would you buy this bond for appreciation?

A. It depends at what level of the market it was selling.

Q. Would you buy it for appreciation at 110 in 1953?

A. Not when it is callable at 105, no.

Q. Would you buy it for the interest rate?

A. I would not.

Q. Why wouldn't you buy it for the interest rate?

A. Well, because the fact that it was selling at a 3.70 yield when new issues were coming at a 3.40 to 3.50 basis, would indicate there was a risk that the bonds would be called and therefore I wouldn't figure that a five point risk would be a prudent risk.

Q. At what price?

A. At regular call for the purpose of refunding it at a lower interest rate.

Mr. Frank: No further questions, your Honor.

The Court: Cross-examination.

Mr. Windhorst: Yes, sir.

[fol. 34] Cross examination.

By Mr. Windhorst:

Q. In your testimony, you referred to a sinking fund in the Arkansas four and a quarter bonds. Do you know what other funds were available from which the bonds could have been redeemed at the special call price?

A. I believe that there were three or found (sic) funds by which they could be redeemed, and there was, in my opinion, only one of those type of funds—

Q. Go ahead.

A. —in which there would be any likelihood that the bonds could be redeemed.

Q. It was available to redeem the bonds out of the general maintenance and improvement fund, was it not?

A. I believe so.

Q. There could have been sufficient cash in that fund for the redemption of the bonds at the special call price?

A. As I recall, this was an issue of around 25 million.

Q. I correct you, sir. It was 18 million.

A. Eighteen million, all right. I don't believe there was ever anywheres near that amount in either the property betterments fund or the maintenance fund.

Q. Do you know what they could have been—the percentage of gross revenues?

A. Not in this issue.

[fol. 35] Q. How do you know, in reference to your last answer, how do you justify your answer if you don't know what was to be put into the general maintenance and improvement fund?

A. Simply on the basis of experience that no utility bond has ever called its bond in full at the single fund or maintenance price.

Q. It is not for the reason that the cash wasn't there and couldn't have been called if they had so chosen?

Mr. Frank: Objection.

The Witness: This company was not—

Mr. Windhorst: Will you read the question to the witness?

(Question read.)

The Witness: Well, I don't believe a utility of this size would have had 18 million handy in funds to call the bonds at a sinking fund price.

By Mr. Windhorst:

Q. Do you know what the gross revenues were of this company?

A. No.

Mr. Frank: We object. He has testified as to his experience, as to his knowledge from a Wall Street angle as to whether these have ever been redeemed, and from that knowledge, he draws the conclusion that they do not have cash in those particular funds. I don't believe Mr. Beuchler [fol. 36] is a director of any of those corporations, although he may be.

The Court: Much latitude was allowed you on your examination. I intend to allow a great deal of latitude on this examination. It doesn't seem like much, but for what

it is worth, it is going into the testimony. You may answer, if you can.

The Witness: I don't recall in this particular company the exact revenues of the company, but I do recall they were earning their interest charges about three times at the time.

By Mr. Windhorst:

Q. You say that in your particular firm, that you were constantly bidding for bonds. What do you mean by that, sir?

A. Utility issues and municipalities that they are going to sell a bond, we will meet on April 21 at eleven o'clock. We are a participating underwriter in practically any issue of any size that comes along.

Yesterday we bought with Merrill Lynch as chief underwriter five million Diamond State Telephone bonds. We went along around half a million dollars. We go to a price meeting and decide whether we will stay or not as to whether it is a fair offer.

Q. Your firm is not the usual broker buying and selling for customers, for clients?

[fol. 37] A. No, that is not right. Our firm's principal business is buying and selling for individual clients in stocks and commodities, but I had an underwriting department for the firm and it is an important part of the business, but it is nowhere near the main part of the business.

Q. Did you have any clients of your own to whom you sold any of those public utility bonds or bought any public utility bonds for?

A. No, sir.

Q. Now, Mr. Beuchler, would you please give your opinion as to what would be the approximate amount of premium that an investor would have to pay in an open amount for a 30-year, 100 dollar face value grade "A" utility bond, bearing four and a quarter percent interest rate, and also assuming that it was issued at a time when the prevailing interest rate was three and a half percent, and further assuming that that particular bond was not callable until maturity?

A. Are you referring to 1953, or not?

Q. At the time the 30-year bond was issued at four and a quarter percent interest rate and at a time when the prevailing interest rate was three and a half percent and the bonds were not callable until maturity, what would be the amount of premium that would have to be paid for that particular bond?

Mr. Frank: Objection. The last part of Mr. Windhorst's [fol. 38] hypothetical question states facts which are not pertinent to this case. He added the caveat that the bond would not be callable for the thirty years duration.

The fact is in this case that it was callable during the 30-year period and this would influence the price paid for the bonds.

The Court: Overruled.

The Witness: Those bonds came out—

By Mr. Windhorst:

Q. I have asked you a hypothetical question.

The Court: It is just hypothetical. You assume all the facts counsel stated?

By Mr. Windhorst:

Q. I am assuming a 30-year hundred dollar face value grade "A" utility bond bearing four and a quarter rate of interest, issued at a time when the prevailing interest rate in the money market was three and a half percent, and further assuming that that particular bond was not callable until the end of the 30 years, what would be the amount of premium that would have to be paid by an investor with respect to that bond?

A. Well, I have got a yield book with me and I will give you what the equivalent yield book is, provided it is a non-callable bond. The 350 yield on a 30-year, four and a quarter percent bond, non-callable, the price is 115.86; [fol. 39] provided it is non-callable.

Q. Now, Mr. Beuchler, now assuming another set of facts, you have a 30-year 100 dollar face value, Grade "A" utility bond, bearing four and a quarter percent interest

rate issued when the prevailing rate of interest was three and a half percent, and further assuming it was issued subject to the provision of being callable at $105 at any time prior to maturity upon 30 days' notice—to what extent would such a call provision affect the amount of premium to be paid for the bond?

A. Well, I think it would affect it considerably, because you have a distinct risk of call when you buy a bond above call price. In fact, some institutions won't buy bonds that are above the call price or above a minus yield to the first called date, allowing 30 days or six months, whatever the notice may be.

Q. How would it affect it, sir?

A. It should have the effect of holding it reasonably close to the call price provided there are no other factors in the situation.

Q. In other words, the premium you would pay would be less than the 13 points you testified with respect to a bond which did not have the call provision, is that right?

A. That is right.

Q. Now, assuming a third set of facts, you have a [fol. 40] 30-year public utility "A" bond of $100 face value, bearing four and a half percent interest rate, which was issued at a time when the prevailing rate of interest was three and a half percent, but in addition to having a general call provision at $105, you have a special call provision at $102.

Will you give us your opinion as to what the effect of that special call price of $102 would be, would have as to the amount of premium which would be paid with respect to such a bond as I described it?

Mr. Frank: This is not an objection, but a clarification. The question was phrased in the terms of four and a half.

By Mr. Windhorst:

Q. Four and a quarter. I am sorry.

A. It would have some call price but because it is only one percent of the total amount outstanding, it would tend to hold the price down somewhat, but because of the small amount—

If this is an eighteen million dollar issue, the most that could be called would be 180,000 a year.

Q. Assuming you looked to the sinking fund, but what if you looked as to the other possibilities of the general maintenance and improvement fund, the possibility that property might be released and also funds would be available from either condemnation or eminent domain, they [fol. 41] would affect your answer, too, wouldn't they?

A. They would.

Q. Which would further decrease the amount of premium which would be paid for the bond?

A. Yes, that is right.

Mr. Windhorst: Petitioner rests.

Mr. Frank: I have a couple on redirect.

Redirect examination.

By Mr. Frank:

Q. I believe your answer to the last question was that if the bonds were also redeemable from those other funds that counsel for petitioners mentioned, such as the maintenance and replacement fund and the released property fund and the eminent domain fund, that the price paid for the bond would be somewhat decreased, is that right?

A. That is right.

Q. Would it make a difference, were you speaking of a public utility?

A. Yes.

Q. Would it make any difference if that public utility were an expanding utility?

A. Well, I think you would be careful of any bond that had a sizeable sinking fund. This wasn't particularly a large sinking fund, so I don't think it would have too much effect, as I said, as it is only one percent of 18 million.

[fol. 42] Q. But if they could be redeemed from also those other funds and they were a type of company that was an expanding utility and that needed its cash, would it be likely that they would be redeemed from the maintenance and replacement fund?

A. I don't think so.

Q. Would it be likely that they would be redeemed from the released property fund?

The Court: The question is not whether they would likely, but the question is, as I get it, is the amount of premium depressed by those factors; rather than asking him whether they would be likely to do it, isn't your question whether or not the amount of premium would be depressed by these factors?

Mr. Frank: Yes, sir, that is correct. It would seem that there should be a correlation.

The Court: You are asking him if they would be likely to do it. I think your question is whether or not the amount of premium would be depressed, isn't that what you mean?

Mr. Frank: That is right.

By Mr. Frank:

Q. Would the amount of premium be depressed if the company was an expanding utility and a company which needed its cash, but which could redeem its bonds from its [fol. 43] maintenance and replacement fund, would the amount of the premium be depressed under those facts?

A. I don't think so. The amount of bonds that were being redeemed, if any, were so small that I don't think it had any effect on the market factor there.

Q. Let me ask you one more question on redirect, in covering something that was asked you on cross-examination.

I take it that public utility bonds are sold and sold to a large measure by your office, is that right?

A. That is right.

Q. And they are sold by your division?

A. Right.

Q. And you are familiar with what customers are willing to pay for certain bonds, for public utility bonds, is that right?

A. Right. There is a difference; I might add this: there is a difference in attitude very sharply between individuals and institutions.

Mr. Frank: No further questions.

Recross examination.

By Mr. Windhorst:

Q. You testified you primarily dealt with institutions, right?

A. Well—

Q. Am I to understand the testimony you gave this noon [fol. 44] relates to institutional buyers?

A. I said that the bulk of the business in the corporate bond end was with institutions.

As a matter of fact, we were selling some of those bonds for institutions at the time that this great wave of buying was on, and that the bonds were selling substantially above the call price.

Mr. Frank: If your Honor please—

The Court: Are you finished?

Mr. Windhorst: No, your Honor.

Mr. Frank: Go ahead.

Mr. Windhorst: May I have just a minute?

By Mr. Windhorst:

Q. You have testified in answer to a question by government counsel that the likelihood of having these Arkansas bonds redeemed—why was it that a special provision calling for redemption at a special call price was inserted in the bond, sir?

A. To satisfy the prospective buyers that a certain amount of the debt would be retired regularly. Some of the institutional buyers demand such a clause or provision.

Q. It is a risk, it is a calculated risk that any buyer who is an institutional buyer or an individual has to take when he buys the bond which has a provision of this type? [fol. 45] A. Yes, but when they come out at the issue fund, it is never above the sinking fund call price. It is only later on, when they tried in the market.

I have never known a bond to be issued above the sinking fund call price.

Mr. Windhorst: That is all.

Mr. Frank: One more question.

Further redirect examination.

By Mr. Frank:

Q. To your knowledge, do individuals often buy half a million dollars worth of bonds?

Mr. Windhorst: I object.

The Court: Sustained.

Mr. Windhorst: He testified he dealt with institutional buyers and not individuals.

The Court: Sustained.

Mr. Frank: No more questions.

The Court: That is all. You may be excused, sir.

(Witness excused.)

Mr. Windhorst: Petitioner rests, your Honor.

The Court: Do you rest, Mr. Frank?

Mr. Frank: Yes, your Honor.

The Court: The case is committed.

Now, about the filing of briefs, gentlemen, the rules provide for the filing of simultaneous briefs—do you think [fol. 46] it would be any help in this case if you filed seriatim briefs, the petitioner filing a brief and then the Government filing a brief, and then the petitioner replying?

Mr. Windhorst: I would rather have simultaneous briefs.

The Court: The Government usually wants it.

Mr. Windhorst: I would think, myself, unless your Honor views differently, that seriatim briefs wouldn't serve any particular purpose.

Mr. Frank: We would just as soon as (sic) simultaneous briefs, if we can ask for it.

The Court: The rule time is 45 days. Is that sufficient time?

Mr. Frank: Could we request 60 days?

Mr. Windhorst: Yes, I agree.

The Court: Simultaneous briefs in 60 days and either party will have 30 days in which to file a reply.

The Clerk: Original briefs due in 60 days, gentlemen, will be June 22d, and 30 days thereafter for your reply will be July 22d.

The Court: We will close the case.

(Whereupon, at 2:30 o'clock p.m., the hearing in the above-entitled matter was closed.)

[fol. 47]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 66899

JACOB A. GOLDFARB, BERTHA L. GOLDFARB, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION—Filed April 26, 1957

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (bearing symbols UM:Au:R:EF:mw) dated January 30, 1957, and as a basis of their case allege as follows:

1. The petitioners are individuals residing at 895 Park Avenue, New York 21, New York. The return for the period here involved was filed with the District Director of Internal Revenue for the Upper Manhattan District of New York.

2. The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A", was mailed to the petitioners on January 30, 1957.

3. The Commissioner determined a deficiency in income tax for the calendar year 1953 in the amount of $14,708.16, all of which is in controversy.

[fol. 48] 4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

The Commissioner erroneously disallowed a deduction for amortizable bond premium in the amount of $20,000.

5. The facts upon which the petitioners rely as the basis of this case are as follows:

(a) The petitioner, Jacob A. Goldfarb, through the brokerage house of J. R. Timmins & Co., 61 Broadway, New York City 6, New York, purchased, on November

[Stamps—Served May 15, 1957—Entered May 15, 1957]

20, 1953, $200,000.00 face amount of Arkansas Power and Light Company 1st 4¼% 30-year bonds, dated June 1, 1953 at 110 (dollars per $100 face amount), costing him $220,500.00 and $20,000 face amount of identical bonds at 109⅝ (dollars per $100 face amount), costing him $21,975.00 and, on November 23, 1953, $380,000.00 face amount of identical bonds at 111 (dollars per $100 face amount), costing him $311,500.

(b) The aforementioned bonds were redeemable on 30 days' call notice prior to their fixed maturity dates at either (1) a general redemption price, or (2) a special redemption price.

(c) The general redemption price specified with respect to the aforementioned bonds was $105.36 (per $100 face amount) if called during the 12-month period ending May 31, 1954. The special redemption price specified with respect to such bonds was $101.36 (per $100 face amount) if called during the same period.

[fol. 49] (d) By reason of the aforementioned bonds being callable for redemption at any time upon 30 days' notice, the earlier-than-maturity call date with respect to such bonds was 30 days after the date of their purchase by petitioner, Jacob A. Goldfarb.

(e) All the bonds purchased by the petitioner, Jacob A. Goldfarb, were subject to being called at the special redemption price in accordance with the provisions of the Arkansas Power and Light Company's mortgage and deed of trust securing the bonds.

(f) The petitioner claimed a deduction of $47,175.00 on their 1953 income tax return for amortization of the bond premium paid on the above described purchases, based on the excess of the total purchase cost of $553,975.00 over the total special redemption price of $506,800.00 ($101.36 per $100 face amount) specified for redemption during the 12-month period ending May 31, 1954.

(g) The Commissioner allowed the deduction for amortization of bond premium to the extent of $27,-

175.00 and disallowed the balance thereof amounting to $20,000.00 on the erroneous ground that the general redemption price and not the special redemption price was applicable in computing the amount of amortizable bond premium.

[fol. 50] Wherefore, the petitioners pray that the Court may hear this case and determine that there is no deficiency in income tax for the calendar year 1953, and give such other and further relief as in the premises the Court may deem fit and proper.

Karl W. Windhorst, Counsel for Petitioners, Rm. 2001, 125 Park Avenue, New York 17, New York.

[fol. 51] *Duly sworn to by Jacob A. Goldfarb and Bertha L. Goldfarb, jurat omitted in printing.*

[fol. 52]

EXHIBIT A TO PETITION

(Seal of the
Treasury Dept.)

U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
DISTRICT DIRECTOR

IN REPLY REFER TO
UM:Au:R:EF:mw

Jan 30 1957

Mr. Jacob A. Goldfarb and Mrs. Bertha L. Goldfarb
Husband and Wife
895 Park Avenue
New York 21, New York

Dear Mr. and Mrs. Goldfarb:

The determination of your income tax liability for the taxable year(s) ended December 31, 1953, discloses a deficiency or deficiencies of $14,708.16, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, WASHINGTON 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed agreement form (Form 870) and forward it to the District Director of Internal Revenue, Audit Division, P. O. Box 1706, Grand Central Annex, New York 17, New York. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earliest.

Very truly yours,

Russell C. Harrington
Commissioner

By /s/ KENNETH W. MOE
District Director of Internal Revenue

Enclosures:
Statement
Pub. #160
Agreement form (Form 870)
Form 1230 (Rev. 6-56)

[fol. 53] STATEMENT

Jacob A. Goldfarb and Bertha L. Goldfarb
Husband and Wife
895 Park Avenue
New York 21, New York

Tax Liability for the Taxable Year Ended December 31, 1953

Income Tax

Deficiency $14,708.16

In making this determination of your income tax liability, careful consideration has been given to the report of examination, a copy of which was transmitted to you under date of November 21, 1956.

Adjustments to Net Income

Net income disclosed by return		**$ 81,035.36**
Unallowable deductions and additional income:		
(a) Miscellaneous, travel and entertainment	**$ 1,000.00**	
(b) Miscellaneous, bond premium amortization	**20,000.00**	**21,000.00**
Net income adjusted		**$102,035.36**

Explanation of Adjustments

(a) This adjustment has been previously explained and agreed to by you.

(b) The deduction claimed on your return for bond premium amortization, has been disallowed to the extent shown inasmuch as it has not been substantiated as allowable under the provisions of the Internal Revenue Code.

COMPUTATION OF TAX

Net income adjusted		$102,085.36
Less: Exemptions (4)		2,400.00
Balance subject to tax		$ 99,635.36
Income tax liability		$ 57,558.52
Alternative tax liability		$ 57,244.90
Income tax liability disclosed by return	$41,816.74	
Add: Additional tax previously assessed	720.00	42,536.74
Deficiency in income tax		$ 14,708.16

[fol. 54]

TAXABLE YEAR ENDED DECEMBER 31, 1953

COMPUTATION OF ALTERNATIVE TAX

Corrected income subject to tax	$99,635.36
Less: Excess of net long-term gain over short-term loss	1,363.64
Balance subject to surtax and normal tax	$98,271.72
Surtax and normal tax liability	$56,535.80
Add: 52% of excess of net long-term gain over short-term loss	709.10
Alternative tax liability	$57,244.90

[fol. 60] [File endorsement omitted]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 66899

JACOB A. GOLDFARB, BERTHA L. GOLDFARB, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

STIPULATION OF FACTS—Filed April 22, 1959

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true, or to object to any fact herein stipulated on the grounds of immateriality or irrelevancy.

1. The petitioner, Jacob A. Goldfarb, through the brokerage house of J. R. Timmins & Co., 61 Broadway, New York City 6, New York, purchased, on November 20, 1953, $200,000.00 face amount of Arkansas Power and Light Company 1st 4¼% 30-year bonds, dated June 1, 1953, at 110 (dollars per $100 face amount), costing him $220,500.00 and $20,000.00 face amount of identical bonds at 109⅝ (dollars per $100 face amount), costing him $21,975.00 and, on November 23, 1953, $280,000.00 face amount of identical bonds at 111 (dollars per $100 face amount), costing him $311,500.00. The total cost of the aforementioned Arkansas bonds to the petitioner, Jacob A. Goldfarb, was $553,975.00 [fol. 61] which included brokerage commissions of $1,250.00. These bonds which were Public Utility A bonds will be hereinafter referred to as "Arkansas 4¼% bonds" or sometimes as "Eighth Series bonds". Arkansas Power and Light Company is hereinafter sometimes referred to as the "Company."

2. The purchase price of the Arkansas 4¼% bonds, $553,975.00 plus accrued interest in the amount of $10,488.05, was paid to J. R. Timmins & Co. by the petitioner, Jacob A. Goldfarb, in the following manner:

a. By personal check on the Bank of the Manhattan Company in the amount of $74,463.05.

b. By obtaining a loan in the amount of $490,000.00 at 3½% per annum from the First Wisconsin National Bank of Milwaukee. The loan was made on petitioner, Jacob A. Goldfarb's personal six months' note dated November 27, 1953, and his deposit as security of the $500,000.00 face amount of the Arkansas 4¼% bonds. (Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

3. The Arkansas 4¼% bonds were redeemable on 30 days' call notice prior to their fixed maturity date at either (1) at general redemption price from general funds or (2) a special redemption price from certain funds hereinafter specified.

4. The general redemption price specified with respect to the Arkansas 4¼% bonds was $105.36 (per $100 face amount) if called during the 12-month period ending May 31, 1954. The special redemption price specified with respect to such bonds was $101.36 (per $100 face amount) if called during the same period.

[fol. 62] ~~5. By reason of the Arkansas 4¼% bonds being callable for redemption at any time upon 30 days' notice, the earlier-than-maturity call date with respect to such bonds was 30 days after the date of their purchase by petitioner, Jacob A. Goldfarb.~~

V F Jr.
K W W

6. All the Arkansas 4¼% bonds purchased by the petitioner, Jacob A. Goldfarb, were subject to being called at the special redemption price in accordance with the provisions of the Arkansas Power and Light Company's Mortgage and Deed of Trust dated as of October 1, 1944, the Third Supplemental Indenture dated as of October 1, 1949,

and the Seventh Supplemental Indenture dated as of June 1, 1953.

7. The petitioners claimed a deduction of $47,175.00 on their 1953 income tax return for amortization of the bond premium paid on the above described purchases, based on the excess of the total purchase cost of $553,975.00 over the total special redemption price of $506,800.00 ($101.36 per $100 face amount) specified for redemption during the 12-month period ending May 31, 1954.

8. The Commissioner allowed the deduction for amortization of bond premium to the extent of $27,175.00 and disallowed the balance thereof amounting to $20,000.00.

9. On February 1, 1954, petitioner Jacob A. Goldfarb paid $20,000.00 to the First Wisconsin National Bank of Milwaukee in reduction of his note referred to in paragraph 2 hereinabove. The balance of the note in the amount of $470,000.00 was paid on May 28, 1954, with the proceeds of two loans hereinafter set forth in paragraphs 10 and 11. In the year 1954, petitioner paid the amount of $8,330.38 as interest to the First Wisconsin National Bank of Milwaukee on said note.

[fol. 63] (Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

10. On May 28, 1954, the amount of $235,000.00 was borrowed by petitioner, Jacob A. Goldfarb, from the Citizens Fidelity Bank and Trust Company of Louisville, Kentucky, on his personal 60-day, 3% note dated May 28, 1954, and his deposit as security of $250,000.00 face amount Arkansas 4¼% bonds which had been transferred from the First Wisconsin National Bank. The petitioner paid, in 1954, an amount of $372.09 as interest to the Citizens Fidelity Bank and Trust Company of Louisville, Kentucky.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

11. On May 27, 1954, the amount of $235,000.00 was borrowed by petitioner, Jacob A. Goldfarb, from the First

National Bank of Kansas City on petitioner, Jacob A. Goldfarb's 60-day, 3% note dated May 27, 1954, and his deposit as security of $250,000.00 face amount Arkansas 4¼% bonds which had been transferred from the Wisconsin National Bank. The petitioner paid, in 1954, an amount of $391.67 as interest to the First National Bank of Kansas City.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

12. On June 16, 1954, the petitioner, Jacob A. Goldfarb, sold the $500,000.00 face amount Arkansas 4¼% bonds for $527,000.00, less commissions and selling expenses of $875.00. Petitioner, Jacob A. Goldfarb, reported a long term capital gain on his tax return for 1954 using a basis of $506,800.00 for said bonds.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

[fol. 64] 13. On June 17, 1954, the loan from the First National Bank of Kansas City and the loan from the Citizens Fidelity Bank and Trust Company of Louisville, Kentucky, were paid by petitioner, Jacob A. Goldfarb. Payment was made by using the proceeds of the sale of the Arkansas 4¼% bonds.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

14. The purchase and sale of the Arkansas 4¼% bonds were handled by J. R. Timmins & Co. as broker for the petitioner, Jacob A. Goldfarb.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

15. All the issued and outstanding Arkansas 4¼% bonds were redeemed by the Company at the general call price of $105.18 on April 18, 1955.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

16. The Arkansas 4¼% bonds, as well as the other outstanding bonds, were redeemable at the option of the com-

pany at the special call price only for cash if such cash were available in the sinking and improvement fund of the Arkansas 4¼% bonds, the maintenance and replacement fund, or the fund for released property or the fund for property taken by eminent domain in accordance with the provisions of the Mortgage and Deed of Trust and Supplementary Indentures thereto.

17. The Arkansas Power and Light Company had the option of transferring certain cash to the general maintenance and replacement fund and the option of transferring certain cash to the sinking and improvement fund of the [fol. 65] Arkansas 4¼% bonds. Any cash available in these funds or in the released property fund and eminent domain fund could have been used to redeem by lot the Arkansas 4¼% bonds. If the Company had exercised said options, it could have made available sufficient cash in the maintenance and replacement fund (or to the extent permitted pursuant to Article 2, Section 2 of the Seventh Supplemental Indenture in the sinking and improvement fund of the Arkansas 4¼% bonds) or, if certain events had transpired, there might have been available sufficient cash in the released property fund or in the eminent domain fund which could have permitted the Company to redeem the Arkansas 4¼% bonds pursuant to the terms of mortgage and Deed of Trust and Supplemental Indentures thereto and which could have resulted in the redemption at the special call price prior to December 31, 1953, of all of the bonds of the Company having a face value of $500,000.00 owned by petitioner Jacob A. Goldfarb.

18. No cash was placed in the sinking and improvement fund for the Arkansas 4¼% bonds during the time that these bonds were outstanding. In lieu of the cash to be placed in the sinking and improvement fund, the Company elected other options such as taking a credit for the amount of bonds, the authentication and delivery of which could have been issued under the mortgage but which authentication and delivery had been waived.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

19. No cash was placed in the maintenance and replacement fund of the Company during the time that the Arkansas 4¼% bonds and all the other bonds of the Company, set forth in paragraph 21, were outstanding. In [fol. 66] lieu of the cash requirements for the maintenance and replacement funds of the various series of bonds specified in paragraph 21 and the Arkansas 4¼% bonds during the time that said bonds were outstanding, expenditures for maintenance, repairs and gross property additions were certified by the Company.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

20. No property was released and no property was taken by eminent domain and therefore no cash was placed in the released property fund or property taken by eminent domain fund of the Arkansas 4¼% bonds and all the other bonds of the Company, set forth in paragraph 21, during the time that these bonds were outstanding.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

21. No cash was placed in the general maintenance and replacement fund or in the sinking or improvement fund of the following listed bonds issued by the Company during the time that they were outstanding:

First Mortgage Bonds

3⅛s	Series	due	1974
2⅞s	"	"	1977
3⅛s	"	"	1978
2⅞s	"	"	1979
2⅞s	"	"	1980
3⅝s	"	"	1981
3½s	"	"	1982
3¼s	"	"	1984
3⅜s	"	"	1985

[fol. 67] (Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

22. In lieu of cash placed in the sinking and improvement funds of the various series of bonds during the time that said bonds were outstanding, specified in paragraph 21, the Company elected other options such as taking a credit for the amount of bonds, the authentication and delivery of which could have been issued to the mortgage but which authentication and delivery had been waived.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

23. The various series of Arkansas 4¼% bonds, specified in paragraph 21, are still outstanding and have not been redeemed at either their general or special call price.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

24. It was the Company's practice to use its cash with which it could have satistied its obligations to the certain funds in its substantial construction program.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

25. The issuance and redemption of the Arkansas 4¼% bonds were governed by the provisions of the Mortgage and Deed of Trust dated as of October 1, 1944, the Third Supplemental Indenture dated as of October 1, 1949, and the Seventh Supplemental Indenture dated as of June 1, 1953. Each of the said documents are attached hereto and marked Exhibits 1-A, 2-B and 3-C, respectively.

[fol. 68] 26. Petitioners file their income tax returns on the calendar year basis and use the cash basis method in reporting income and deductions. The petitioners' Federal income tax return for the year 1953 is attached hereto and marked Exhibit 4-D.

27. A schedule showing the total electric operation revenues, total energy sold and the total electric customers of the Arkansas Power and Light Company for the years 1948 to 1957 is attached hereto and marked Exhibit E.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

28. A copy of an officers' certificate delivered by the Company to the corporate trustee on September 27, 1953, in connection with the sinking and improvement funds is attached hereto and marked Exhibit F.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

29. A schedule showing the average of yields (in percent) on Public Utility A Bond during the latter half of 1953, as reported in Moody's Public Utility Manual 1954, and the yields on a 30-year bond selling at $110.00 and other prices, is attached hereto and marked Exhibit 7-G.

30. A copy of the officers' certificate delivered by the Company to the corporate trustee on March 22, 1954, in connection with the maintenance and replacement fund is attached hereto and marked Exhibit H.

(Petitioners object to the allegations of this paragraph on the grounds of immateriality and irrelevancy.)

[fol. 69] 31. A specimen copy of the type of bond, which type petitioner Jacob A. Goldfarb purchased, is attached hereto and marked Exhibit 9I.

32. Moody's Public Utility Manual (1954) recites that the Arkansas 4¼ bonds were offered at 101.36 on June 12, 1953 by Merrill Lynch, Pierce, Fenner and Beane and Union Securities Corporation, New York, and associates; that the proceeds to the Company were 100.8099, that the price range for 1953 was 115-99⅜.

A schedule of the monthly prices of the Arkansas 4¼ bonds during 1953 is attached hereto as Exhibit 10J.

Karl W. Windhorst, Counsel for Petitioners.

Arch M. Cantrall, Counsel for Respondent.

[fol. 182]

33 T. C. No. 63

BEFORE THE TAX COURT OF THE UNITED STATES

JACOB A. GOLDFARB, BERTHA L. GOLDFARB, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 66899

Held, taxpayer not entitled to deduct, under section 125 I.R.C. of 1939, through amortization, the premium paid on bonds measured by the excess of the cost of bonds over a special redemption price instead of excess of cost over general redemption price. *Estate of A. Gourielli, Deceased, et al.*, 33 T.C. —— (November 30, 1959) followed.

Karl W. Windhorst, Esq., for the petitioners.

Victor H. Frank, Jr., Esq., for the respondent.

Findings of Fact and Opinion—Filed and Served December 24, 1959

MULRONEY, Judge:

Respondent determined a deficiency in the petitioners' income tax for the year 1953 in the amount of $14,708.16. The only issue for decision is whether the petitioners are entitled to a deduction for the amortization of bond premiums under section 125 (b) of the Internal Revenue Code [fol. 183] of 1939[1] measured by the excess of cost over the special redemption rate of $101.36, as contended by the petitioners.

Findings of Fact

Some of the facts have been stipulated and they are hereby incorporated by this reference.

Jacob A. Goldfarb and Bertha L. Goldfarb, husband and wife, are residents of the New York City, New York.

[1] All section references are to the Internal Revenue Code of 1939, as amended.

They filed a joint income tax return for the year 1953 with the district director of internal revenue for the Upper Manhattan District of New York. Jacob A. Goldfarb will hereinafter be called the petitioner.

Petitioner purchased through a broker on November 20, 1953, $200,000 face amount of Arkansas Power and Light Company 1st 4¼ per cent 30-year bonds (dated June 1, 1953) at 110, costing him $220,500; $20,000 face amount of identical bonds at 109⅝, costing him $21,975; and on November 23, 1953, $280,000 face amount of identical bonds at 111, costing him $311,500. The total cost of the bonds to the petitioner was $553,975, which included brokerage commissions of $1,250. The bonds will hereafter sometimes be called the Eighth Series bonds, or the Arkansas 4¼ per cent bonds. Arkansas Power and Light Company will hereafter be called Arkansas.

[fol. 184] The purchase price in the amount of $553,975, plus accrued interest in the amount of $10,488.05, was paid by the petitioner in the following manner: by personal check in the amount of $74,463.05; and by obtaining a loan in the amount of $490,000 at 3½ per cent per annum from the First Wisconsin National Bank of Milwaukee, on petitioner's personal six months' note dated November 27, 1953 and the deposit as security of the $500,000 face amount of the Arkansas 4¼ per cent bonds. On May 27, 1954 petitioner borrowed $235,000 from the First National Bank of Kansas City on his personal 60-day 3 per cent note, and deposited as security $250,000 face amount of Arkansas 4¼ per cent bonds which had been transferred from the Wisconsin National Bank. On May 28, 1954, the petitioner borrowed $235,000 from the Citizens Fidelity Bank and Trust Company of Louisville, Kentucky, on his personal 60-day 3 per cent note, and deposited as security $250,000 face amount of Arkansas 4¼ per cent bonds which had been transferred from the First Wisconsin National Bank. By May 28, 1954, the petitioner had paid off in full his note given to the First Wisconsin National Bank.

On June 16, 1954 the petitioner sold the $500,000 face amount of Arkansas 4¼ per cent bonds for $527,000, less commissions and selling expenses of $875. Petitioner reported a long-term capital gain on his income tax return

[fol. 185] for 1954 using a basis of $506,800 for the bonds.

The issuance and redemption of the Arkansas 4¼ per cent bonds were governed by the provisions of the Mortgage and Deed of Trust dated as of October 1, 1944, the Third Supplemental Indenture dated as of October 1, 1949, and the Seventh Supplemental Indenture dated as of June 1, 1953.

The Arkansas 4¼ per cent bonds were redeemable on 30 days' call notice prior to their fixed maturity date at either (1) the general redemption price from general funds or (2) the special redemption price from certain special funds. Both the general and the special redemption prices decreased yearly. The general redemption price was $105.36 if the Arkansas 4¼ per cent bonds were called during the 12-month period ending May 31, 1954. The special redemption price was $101.36 if the bonds were called during the same period.

All of the issued and outstanding Arkansas 4¼ per cent bonds were redeemed by Arkansas at the general call price of $105.18 on April 18, 1955.

The Arkansas 4¼ per cent bonds were redeemable at the option of the company at the special call price only for cash if such cash were available in the sinking and improvement fund of the Arkansas 4¼ per cent bonds, the maintenance and replacement fund, or the fund for released property or fund for property taken by eminent domain in accordance with the provisions of the Mortgage and Deed of Trust and Supplementary Indentures.

[fol. 186] Arkansas had the option to transfer certain cash to the maintenance and replacement fund, and the option to transfer certain cash to the sinking and improvement fund of the Arkansas 4¼ per cent bonds. Any cash available in these funds or in the released property fund and eminent domain fund could have been used to redeem by lot the Arkansas 4¼ per cent bonds. If Arkansas had exercised the options, it could have made available sufficient cash in the maintenance and replacement fund (or, to the extent permitted pursuant to Article 2, Section 2 of the Seventh Supplemental Indenture, in the sinking and improvement fund of the Arkansas 4¼ per cent bonds) or, if certain events had transpired, there might have been

available sufficient cash in the released property fund or in the eminent domain fund which could have permitted Arkansas to redeem the Arkansas 4¼ per cent bonds pursuant to the terms of the mortgage and Deed of Trust and Supplemental Indentures, and which could have resulted in the redemption at the special call price prior to December 31, 1953, of all the Arkansas 4¼ per cent bonds owned by the petitioner.

No cash was placed in the sinking and improvement fund for the Arkansas 4¼ per cent bonds during the time these bonds were outstanding. In lieu of the cash to be placed in the sinking and improvement fund, Arkansas elected other options, such as taking a credit for the amount of bonds, the authentication and delivery of which would have [fol. 187] been delivered under the mortgage but which authentication and delivery had been waived. No cash was placed in the maintenance and replacement fund of Arkansas during the time that the Arkansas 4¼ per cent bonds, or any of the other bond issues, were outstanding. In lieu of the cash requirements for the maintenance and replacement funds of the various series of bonds, including the Arkansas 4¼ per cent bonds, during the time that said bonds were outstanding, expenditures for maintenance, repairs and gross property additions were certified by Arkansas. No property was released and no property was taken by eminent domain and, therefore, no cash was placed in the released property fund or property taken by eminent domain fund of the Arkansas 4¼ per cent bonds.

It was the practice of Arkansas to use its cash, with which it could have satisfied its obligations to the certain funds, in its substantial construction program.

No cash was placed in the general maintenance and replacement fund or in the sinking or improvement fund of the following first mortgage bonds issued by Arkansas during the time that these bonds were outstanding:

3⅛s	Series	due	1974
2⅞s	"	"	1977
3⅛s	"	"	1978
2⅞s	"	"	1979
2⅞s	"	"	1980

3⅝s	Series	due	1981
3½s	"	"	1982
3¼s	"	"	1984
3⅜s	"	"	1985

[fol. 188] These issues are still outstanding and have not been redeemed at either their general or special call price.

The business of Arkansas was expanding. Its total electric operating revenues had more than doubled in the 10-year period ending with 1958. Its construction program was substantial. There was no likelihood that Arkansas would redeem its Arkansas 4¼ per cent bonds at the special redemption price in 1953.

Interest rates on utility bonds declined in 1953 and 1954.

Petitioner claimed a deduction of $47,175 on his 1953 income tax return for amortization of the bond premium paid on his purchase of the Arkansas 4¼ per cent bonds, based on the excess of the total cost of $553,975 over the total special redemption price of $506,800 ($101.36 per $100 face amount) specified for redemption during the 12-month period ending May 31, 1954. The respondent allowed the deduction for amortization of bond premium to the extent of $27,175 and disallowed the balance thereof amounting to $20,000.

Opinion

The only question is whether the petitioners are entitled to a deduction for amortization of bond premiums under section 125 equal to the excess of cost over the special redemption price. This exact question was recently decided by this Court in *Estate of A. Gourielli, Deceased, et al.*, 33 T.C. —— (Nov. 30, 1959), where we re-[fol. 189] jected the petitioner's contention that the amortization deduction under section 125 should be measured by the excess of bond cost over the special redemption price. That case is controlling here.

There is no compelling argument presented here for permitting the special redemption price to measure the total amount of premium to be amortized. Under the facts before us, the special redemption price is unrealistic. Here it can be said as was said in the *Gourielli* case that the rec-

ord shows the bonds could not have been redeemed at the special redemption price at any time while petitioners owned them. Cash for such redemption could only come from certain specified funds, and the bonds in question were redeemable only if such cash were available. No cash was ever placed in any of the funds maintained by Arkansas for this purpose. Instead, Arkansas met its obligations as to these special funds under the pertinent mortgages and deeds of trust by selecting certain options open to it which did not involve cash. The business of Arkansas was expanding and it was engaged in a substantial construction program, and it was its practice to use its available cash for such program.

Under the authority of *Estate of A. Gourielli, Deceased et al., supra,* we sustain respondent.

Decision will be entered for the respondent.

(Seal)

[fol. 190]

BEFORE THE TAX COURT OF THE UNITED STATES

Washington

Docket No. 66899

JACOB A. GOLDFARB, BERTHA L. GOLDFARB, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—Entered December 28, 1959

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed December 24, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1953 in the amount of $14,708.16.

John E. Mulroney, Judge.

(Seal)

[Stamp—Served Dec 30 1959]

[fol. 191] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Tax Court Docket No. 66899

JACOB A. GOLDFARB and BERTHA L. GOLDFARB,
Petitioners on Review,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITION FOR REVIEW—Filed March 23, 1960 in the Tax Court of the United States

To the Honorable Judges of the United States Court of Appeals For the Second Circuit.

Jacob A. Goldfarb and Bertha L. Goldfarb, the above named Petitioners on Review, by their Attorney, hereby petition the United States Court of Appeals for the Second Circuit to review a decision entered by the Tax Court of the United States in the above docketed case on December 28, 1959, in which it was found that there is a deficiency in income tax of the Petitioners on Review for the Calendar Year 1953.

Your Petitioners on Review, Jacob A. Goldfarb and Bertha L. Goldfarb, are individuals residing at Number 895 Park Avenue, New York 21, New York. The Federal [fol. 192] Income Tax Return of the said Petitioners for the Calendar Year 1953, the taxable year here involved, was filed with the District Director of Internal Revenue for what was formerly the Upper Manhattan District of New York, whose office was located in New York, New York. Venue on appeal, therefore, lies in the United States Court of Appeals for the Second Circuit where this review is sought.

This petition for review is filed pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

Nature of the Controversy

The only question presented for decision is whether Petitioners on Review are entitled to a deduction for the amortization of bond premiums under section 125(b) of the Internal Revenue Code of 1939 as measured by the excess of the cost of the bonds over their special redemption price of $101.36 (per $100 face amount). The factual situation in which the question is presented is as follows:

Petitioner on Review Jacob A. Goldfarb, through the brokerage house of J. R. Timmins & Co., 61 Broadway, New York City 6, New York, purchased, on November 20, 1953, $200,000.00 face amount of Arkansas Power and Light Company 1st 4¼% 30-year bonds, [fol. 193] dated June 1, 1953 at 110 (dollars per $100 face amount), costing him $220,500.00 and $20,000 face amount of identical bonds at 109⅝ (dollars per $100 face amount), costing him $21,975.00 and, on November 23, 1953, $380,000.00 face amount of identical bonds at 111 (dollars per $100 face amount), costing him $311,500.

The aforementioned bonds were redeemable on 30 days' call notice prior to their fixed maturity dates at either a general redemption price, or a special redemption price, all in accordance with the provisions of the Arkansas Power & Light Company's mortgage and deed of trust securing the bonds.

The general redemption price specified with respect to the aforementioned bonds was $105.36 (per $100 face amount) if called during the 12-month period ending May 31, 1954. The special redemption price specified with respect to such bonds was $101.36 (per $100 face amount) if called during the same period.

By reason of the aforementioned bonds being callable for redemption at either the general redemption price or the special redemption price at any time upon 30 days' notice, the earlier-than-maturity call date with respect to such bonds was 30 days after the [fol. 194] date of their purchase by Petitioner on Review, Jacob A. Goldfarb.

Petitioners on Review claimed a deduction of $47,175.00 on their 1953 income tax return for amortization of the bond premium paid on the above described purchases, based on the excess of the total purchase cost of $553,975.00 over the total special redemption price of $506,800.00 ($101.36 per $100 face amount) specified for redemption during the 12-month period ending May 31, 1954.

The Commissioner of Internal Revenue allowed the deduction for amortization of bond premium to the extent of $27,175.00 and disallowed the balance thereof amounting to $20,000.00 on the erroneous ground that the general redemption price and not the special redemption price was applicable in computing the amount of amortizable bond premium.

Upon review, the Tax Court of the United States held for the Commissioner and sustained the disallowance of a deduction for the amortization of bond premium as measured by the excess of cost over the special redemption price of the aforesaid bonds.

Wherefore, your Petitioners on Review pray that the United States Court of Appeals for the Second Circuit review the decision and opinion of the Tax Court of the [fol. 195] United States and set aside the same, directing that decision be entered for Petitioners on Review and that the Clerk of the Tax Court be directed to transmit and deliver to the Clerk of this Honorable Court all documents necessary and material to the presentation and consideration of this Petition for Review in accordance with the rules of this Court and the applicable statutes, to the end

that the error herein complained of may be reviewed and corrected by this Honorable Court.

March 22, 1960.

Theodore Tannenwald, Jr., Attorney for Petitioners on Review, Office and Post Office Address, 60 East 42nd Street, New York 17, New York.

[fol. 196] *Duly sworn to by Theodore Tannenwald, Jr. jurat omitted in printing.*

[fol. 206]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 239 and 164—October Term, 1960.

Argued March 7, 1961

Docket Nos. 26258 and 26324

ESTATE OF A. GOURIELLI, Deceased, THE HANOVER BANK, Executor, and HELENA GOURIELLI, Surviving Wife, Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JACOB A. and BERTHA L. GOLDFARB, Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Before: Lumbard, Chief Judge, Waterman and Friendly, Circuit Judges.

Petitions to review decisions of the Tax Court, 33 T. C. 357, Murdock, J., and 33 T. C. 568, Mulroney, J., sustaining the Commissioner's findings of deficiencies in income taxes

[fol. 207] as result of disallowances of amounts claimed as amortizable bond premium. Affirmed.

David Alter (Squadron, Alter & Weinrib, and Hubert Thurschwell, on the brief), New York, N. Y., for Petitioners Estate of Gourielli, et al.

Theodore Tannenwald, Jr. (Weil, Gotshal & Manges, and Martin D. Ginsburg, on the brief), New York City, N. Y., for Petitioners Jacob A. and Bertha L. Goldfarb.

James P. Turner, Att'y, Dept. of Justice (Abbott M. Sellers, Acting Ass't Att'y Gen'l and Lee A. Jackson, Melva M. Graney and John A. Bailey, Att'ys, Dept. of Justice), Washington, D. C., for Respondent in both cases.

OPINION—Decided April 13, 1961

Friendly, Circuit Judge:

The issue in these two cases is whether, in a tax year, 1953, governed by §§23 (v) and 125, added to the 1939 Code by the Revenue Act of 1942, c. 619, §126, 56 Stat. 798, 822, taxpayers who purchased bonds callable on 30 days' notice may deduct, in addition to the excess of their basis over the redemption price at which the issuer could freely call all or any part of the issue, the excess of that price over a lower one at which the issuer could call bonds only out of specially defined funds. In both cases the Tax Court sustained determinations of the Commissioner adverse to the taxpayers. We likewise hold the additional deductions claimed by the taxpayers may not be taken on the facts here. We set forth the relevant sections of the Code in [fol. 208] the margin;[1] we shall follow the parties, and the

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[1] "Sec. 23. *Deductions from Gross Income.*

In computing net income there shall be allowed as deductions:

* * * * *

(v) *Bond Premium Deductions.*—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125.

bond indentures, in referring to the higher of the two prices as a "general" or "regular" redemption price, and to the lower as a "special" redemption price.

In October, 1953, Mr. and Mrs. Gourielli purchased $540,000 principal amount of Appalachian Electric Power Company 3¾% bonds, issued in 1951 and due in 1981, at 117½; the bonds were retained for somewhat over 30 days and then were sold at 115½. The 1981 series was an issue of $17,000,000 out of a total of $157,000,000 outstanding under the same mortgage at the date of the purchase. During the Gourielli's' ownership, the bonds were stated to be sub- [fol. 209] ject to call on 30 days' notice at 105⅜ or, out of certain funds hereafter described, at 102⅜. The taxpayers claimed a deduction for amortization of bond premium of $83,056.07, representing the excess of the cost of the bonds over what would have been received if these had been called at the "special" redemption price of 102⅜; the amortization resulted in the transaction's yielding a short term capital gain. The Commissioner allowed a deduction only of $64,-

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Sec. 125. *Amortizable Bond Premium.*

(b) *Amortizable Bond Premium.—Amount of bond premium.*— For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond. In no case shall the amount of bond premium on a convertible bond include any amount attributable to the conversion features of the bond.

(2) *Amount amortizable.*—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) *Method of determination.*—The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary."

831.07, the excess of the cost of the bonds over what would have been received at the "regular" redemption price of 105⅜.

In late November, 1953, Mr. Goldfarb purchased $500,000 principal amount of Arkansas Power & Light Company 4¼% bonds, issued in 1953 and due in 1983, at an average price of approximately 110½. The 1983 series was an issue of $18,000,000 out of a total of $104,200,000 outstanding under the same mortgage at the date of the purchase. At the time the bonds were stated to be subject to call on 30 days' notice at 105.36 or, out of certain funds hereafter described, at 101.36. Mr. Goldfarb claimed a deduction for amortization of bond premium of $47,175, representing the excess of the cost of the bonds over what would have been received if they had been called at the "special" redemption price of 101.36. The Commissioner allowed a deduction only of $27,175, the excess of the cost of the bonds over what would have been received at the "general" redemption price of 105.36. The bonds were sold in June, 1954, for $526,125; petitioners reported a long term capital gain.

In both cases the company's right to redeem the bonds on 30 days' notice, in whole or in part, at the "regular" price was unconditional; in both, the right to redeem at the "special" price was limited to the application to that end of certain funds narrowly defined in the indentures. In both, also, when less than an entire series was to be called, the bonds to be redeemed were to be determined by lot.

[fol. 210] The Appalachian bonds held by the Gouriellis were redeemable at the "special" price only "by the use or application of cash deposited pursuant to Section 20 or Section 40 of the Mortgage or by the use of proceeds of released property or the proceeds of insurance." Section 20 of the Mortgage required the company, on or before March 1 of each year, beginning with 1953, to deliver to the mortgage trustee an amount in cash or principal amount of bonds of the 1981 Series equal to 1% "of the greatest principal amount of bonds of the 1981 Series theretofore at any one time outstanding," less credits of 60% of the cost or fair value of any property additions and of 100% of the principal of any bonds which the company would have been entitled to issue, under a provision permitting such issu-

ance in an amount not exceeding 70% of the cost or fair value of property additions, but had elected not so to issue. Any cash so paid might be withdrawn upon certification that the company was entitled to issue bonds and had waived its right to do so, or, at the direction of the company, might be used for the purchase or redemption of bonds of the 1981 Series. Section 40 provided that, within four months after the close of each calendar year, the company would furnish the mortgage trustee with a certificate showing whether its expenditures for repairs, maintenance or replacement of the mortgaged property and credits claimed for property additions were more or less than specified percentages of operating revenues; if less, the company was to deposit an amount in cash or bonds equal to the deficiency. The company could withdraw any cash or bonds so deposited against an excess shown in a subsequent certificate; it could withdraw cash against the deposit of bonds at any time; and it also had the same rights with respect to the cash as have been described in the case of Section 20, the purchase or redemption of bonds being here per- [fol. 211] mitted without segregation as to series. This latter right existed also as to cash paid to the trustee as insurance proceeds or for the release of property. Up to the fall of 1953 no cash had ever been paid the trustee pursuant to Section 20 or Section 40, the company's obligations under these sections having been satisfied by credits for property additions. Neither had anything been paid as insurance proceeds. Certain amounts had been paid in connection with the release of property but all these save $184,837.43 had been withdrawn. There is no evidence that any substantial payments for insurance or the release of property were in prospect. It would have been extremely poor business for the company to incur the expenses incident to a call for such a small sum as was available; the chance that the company would engage in so ill-advised an endeavor during petitioners' brief ownership was thus exceedingly remote; and the hazard that any significant number of petitioners' bonds would be called during that period was infinitesimal.

The Seventh Supplemental Indenture under which the Arkansas Power & Light Company bonds of 1983 were issued provided these could be redeemed at the "special"

price only out of "cash delivered to or deposited with the Corporate Trustee pursuant to the provisions of Section 39 or Section 64 of the Mortgage or of Section 2 hereof or Section 3 of the Third Supplemental Indenture or with the proceeds of Released Property." Section 39 of the Mortgage as modified by Section 3 of the Third Supplemental Indenture required that, within 90 days after the close of the calendar year, the company should file a certificate in regard to maintenance and in case of a deficiency make a payment in cash, on lines broadly similar to these described above in connection with the Appalachian mortgage. Cash so paid might be withdrawn against property additions or waiver of the right to issue bonds to which the [fol. 212] company was entitled, or might be directed to be applied to the purchase or redemption of bonds; the trustee was so to apply any cash left with it for five years. Section 64 provided for the payment to the corporate trustee of sums received as the result of the taking of property by eminent domain or its sale to governmental bodies. Section 2 of the Seventh Supplemental Indenture provided that, on or before October 1 of each year beginning with 1954, the company was to deliver to the trustee a certificate showing the greatest principal amount of bonds of the 1983 Series outstanding at any one time prior to January 1 of such year, less the amount retired by application of the proceeds of insurance, the release or other disposition of property, or the taking of property by eminent domain, and less also the principal amount of bonds the right to the issuance of which had been waived pursuant to certain clauses of the mortgage. Along with the certificate the company was to pay, in cash or 1983 bonds, 1% of this balance, less the principal amount of any bonds which the company had the right to issue on the basis of property additions or retirement of 1983 bonds, if the company elected to waive its right to issue such bonds and thereby avail itself of this credit. Section 2 contained a provision permitting the company to anticipate these sinking fund requirements; however, if cash were so paid, bonds called for redemption prior to January 1 of the calendar year in which the payment would otherwise have become due would be redeemable at the "general" rather than the "special" redemption price. In fact, during 1953 the trustee under the Arkansas Power

& Light Co. mortgage held no cash under any of these provisions, with respect to either the 1983 series or any other, and there is no evidence that any receipts were in prospect. The company had satisfied its covenant under the maintenance clause; no property had been taken by gov- [fol. 213] ernmental bodies; nothing had been paid for released property; and the company had availed itself of the credit to eliminate its obligation to pay cash or bonds into the sinking funds for earlier series, no sinking fund obligation with respect to the 1983 series having yet accrued. When the Arkansas bonds were purchased by Mr. Goldfarb in late November, 1953, there was thus no real possibility that any of them would be called at the "special" price that year.[2] On April 18, 1955, the entire issue of 4¼s of 1983 was called at the "general" redemption price, then 105.18.

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[2] The stipulation of facts in the *Goldfarb* case recites that if Arkansas Power & Light Company had exercised certain options:

> "it could have made available sufficient cash in the maintenance and replacement fund (or to the extent permitted pursuant to Article 2, Section 2 of the Seventh Supplemental Indenture in the sinking and improvement fund of the Arkansas 4¼% bonds) or, if certain events had transpired, there might have been available sufficient cash in the released property fund or in the eminent domain fund which could have permitted the Company to redeem the Arkansas 4¼% bonds pursuant to the terms of mortgage and Deed of Trust and Supplemental Indentures thereto and which could have resulted in the redemption at the special call price prior to December 31, 1953, of all of the bonds of the Company having a face value of $500,000.00 owned by petitioner Jacob A. Goldfarb."

We read this to mean only that the company had resources sufficient to enable it to make required payments in cash rather than otherwise—not that the indenture entitled it to pay cash in any amount it chose and avail itself of the "special" redemption price. The indenture gave the company no right to anticipate anything save sinking fund payments, and that right was carefully hedged as regards redemption price as noted in the text; although the company could have paid any amount it chose, no 1983 bonds could have been called at the "special" redemption price in 1953 since no sinking fund payment was due that year. If the quoted language from the stipulation means otherwise, we must disregard it in favor of the controlling provisions of the indentures, which were annexed. *National Marking Mach. Co.* v. *Triumph Mfg. Co.*, 13 F. 2d 6, 9-10 (8 Cir. 1926); *Daugaard* v. *Hawkeye Security Ins. Co.*, 239 F. 2d 351, 354 (8 Cir. 1956).

Despite superficial similarity in language, the two redemption provisions serve entirely different purposes and have quite different effects. The primary purpose of the [fol. 214] provision giving the right to call all or part of the issue at any time is to enable the company to take advantage of a fall in interest rates; the relatively high premiums demanded on such a call, initially 5¾% on the Appalachian bonds and 5.36% on the Arkansas, reflect the lenders' determination to exact a substantial price for something that will deprive them of the benefit of what has proved an advantageous bargain. Dewing, The Financial Policy of Corporations (5th ed. 1953), Vol. I, pp. 187-88. In contrast, the so-called "special" redemption price is an incident, itself unfavorable but only mildly so, in a set of provisions requiring the company to protect the underlying security for the benefit of the lenders—by adequately maintaining the mortgaged property, by conserving the proceeds of property destroyed or sold, and by providing against the ravages of time either through adding new property or through retiring bonds. Although the company is given considerable flexibility in providing this protection by means other than the payment of cash and even is entitled under some circumstances to withdraw cash already paid to the trustee, there is always a possibility that the payment of cash will be the only option attractive to the company from a business standpoint; hence the borrower insists upon a right to call in order to avoid the accumulation of idle cash in the sinking fund or the payment of what it deems an excessive price for the purchase of bonds from unwilling sellers. See *Dewing, supra*, at pp. 247-49. Lenders are willing to permit the company to do this at a price lower than in the general redemption clause,[3] since, even in the event, not generally anticipated in public utility bonds, that the company should elect the cash option, the careful defini- [fol. 215] tion of the funds that may be so applied severely

[3] For the Appalachian bonds the initial special redemption premium was 2⅜%, for the Arkansas bonds only 1.36%. Both the general and special redemption premiums were to decline as the years passed, the two meeting in 1977 in the case of the Appalachian issue.

limits the amount of bonds that can be called, especially during the early life of the issue when the point is of greatest concern, and the consequent risk to the lenders—save for the eventualities, themselves rare, that a large part of the mortgaged property might be destroyed or condemned. Moreover, for reasons that are sufficiently apparent, there is not the same likelihood of exact correlation between a decline in interest rates and a call at the "special" as at the "general" redemption price. By the same token, although the "general" redemption provision normally tends to prevent the market price of the bond from rising too markedly above the call price, since the very existence of such a premium usually shows that interest rates have fallen to a point producing the hazard of a call,[4] the "special" redemption provision exercises no downward pull of similar magnitude in the usual case, since, if any such call were to be made, it would relate in any year to only a small proportion of the bonds, chosen by lot.

We do not think that when Congress provided in §125 of the Code that the amount of bond premium "shall be determined * * * with reference to the amount payable on maturity or on earlier call date," and allowed the deduction as "amortizable bond premium" in any year of "the amount of the bond premium attributable to such year," it meant to include an amount payable on a call at a "special" price of which there was no real possibility during the period for which the amortization is being taken and the deduction claimed. The statute does not say the premium is the excess [fol. 216] of the basis over "the amount payable on maturity or on earlier call date"; it says the premium shall be determined "with reference to" the two factors. One purpose for using this somewhat oblique language was to encompass the adjustments for unamortized bond premium referred to in the clause immediately following, see Regu-

[4] We say "normally" and "usually" since there was evidence that the large premium over the general redemption price commanded by the bonds here in question in the closing months of 1953 was not unrelated to a demand arising from their attractiveness for tax deduction purposes—even on the narrower view as to the permissible deduction conceded by the Commissioner.

lations 118, §39.125(b)-1, but that may not have been the only purpose. A sufficient chink was left to give scope for interpretation, as, indeed, there might well have been without this, for even the words "earlier call date" would call for construction. *Ozawa* v. *United States*, 260 U. S. 178, 194 (1922).

We know that Section 125 was added to the Code because "The want of statutory recognition of the sound accounting practice of amortizing premium leads to incorrect tax results * * *" 77th Cong. 2d Sess., H. R. Rep. No. 2333, p. 47 (1942-2 Cum. Bull. 372, 410). Taxpayers have cited no authority that it is sound accounting practice to provide, within 30 days after acquiring a bond, a reserve large enough to meet not only every risk of call that could eventuate during the amortization period but also one that could not. Cf. *Massey Motors, Inc.* v. *United States*, 364 U. S. 92, 104-06 (1960). Again the House Report tells us that lack of provision for amortization of bond premium had obliged bondholders to pay "a tax, as upon income, upon that portion of the so-called interest payments which is in reality capital recovered * * *" What this means is that an investor who pays $1,100 for a $1,000 5% uncallable bond maturing in ten years will not in fact receive $500 interest over the decade, but only $400, and only the latter should be taxed as income. Similarly, if the issue were callable at 105 on 30 days' notice in whole or in part at the company's option, the premium might indicate sufficient likelihood of a call that in substance the investor would be paying $1100 and be getting back $1050, and since there was no way of [fol. 217] determining when this loss of capital would befall, Congress indulgently allowed him to provide for it at once. This reasoning scarcely applies to a provision entitling the issuer to call what normally is at most a small proportion of the issue each year—at least until the issuer's prospective intention and legal ability to exercise this privilege in a significant way become sufficient to constitute a market factor. Whether a bondholder might be entitled to use a "special" redemption price for computing bond premium if there were circumstances indicating the likelihood of a substantial call at that price when he first elected a method of amortization, or whether, having elected

to amortize to a "general" call price, he might be permitted a further deduction for amortization if facts indicating the likelihood of such a call at the "special" price later appeared, we do not find it necessary here to decide.

Taxpayers seek to find support for a conclusion adverse to the Commissioner in a statement in the reports, quoted in the margin, 83d Cong. 2d Sess., H. R. Rep. No. 1337, pp. 26-27; Sen. Rep. No. 1662, pp. 30-31,[4] accompanying §171 of the 1954 Code, which provided that henceforth amortization could be taken only to a call date more than three years after the date of issuance. Congress' awareness that the rapid amortization of a premium over the redemption price at an early call date, authorized by the 1942 amendment, [fol. 218] had opened a loophole that needed to be narrowed,[5] hardly shows it had initially meant to create an even larger one. Neither are we persuaded to these tax-

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[4] "Amortization of premium on callable bonds (sec. 171)

"Under existing law, a bond premium may be amortized with reference to the amount payable on maturity or on earlier call date, at the election of the taxpayer. In the case of bonds with a very short call feature, such as those providing for call at any time on 30-day notice, the entire premium may be deducted in the year of purchase.

"This provision has given rise to tax-avoidance opportunities. Substantial bond issues have been made subject to a 30-day call, permitting the purchaser to take an immediate deduction for the entire premium against ordinary income. Where the call feature is nominal or inoperative this permits a deduction for an unreal loss, since the market value of the bonds ordinarily remains fairly stable over considerable periods."

[5] The 1954 attempt at narrowing was not effective since "taxpayers found they could accomplish much the same result as under the 1939 Code by using bonds with call dates slightly more than 3 years from the date of the issue of the bonds and by waiting until these bonds are 3 years old before buying or selling them." 85th Cong., 2d Sess., Sen. Rep., No. 1983 (1958), §14. Accordingly the statute was further amended to provide that, for bonds acquired after December 31, 1957, the premium shall be determined "with reference to the amount payable on maturity (or if it results in a smaller amortizable bond premium attributable to the period to earlier call date, with reference to the amount payable on earlier call date) * * *" Technical Amendments Act of 1958, §13(a), 72 Stat. 1606, 1610.

payers' views by the Commissioner's having at one time advised other taxpayers that use of the "special" call price was permissible, in unpublished opinions later revoked by Revenue Ruling 56-398, 1956-2 Cum. Bull. 984-87;[7] such opinions are not binding elsewhere, *Goodstein* v. *C. I. R.*, 267 F. 2d 127, 132 (1 Cir. 1959); *Weller* v. *C. I. R.*, 270 F. 2d 294, 298-299 (3 Cir. 1959), cert. denied, 364 U. S. 908 (1960). We realize also that our decision runs counter to at least the one of the two decisions reported sub nom. *Parnell* v. *United States*, 187 F. Supp. 576 (M. D. Tenn. 1958), affd. 272 F. 2d 943 (6 Cir. 1959), that relates to taxpayer Parnell's holding of the same issue of Appalachian Electric Power bonds as were bought by the Gouriellis, and to *Evans* v. *Dudley*, 188 F. Supp. 9 (W. D. Pa. 1960), now under appeal to the Third Circuit. Finally, we do not consider *Commissioner* v. *Korell*, 339 U. S. 619 (1950), much relied on by taxpayers, to be at all controlling in their favor. That decision was concerned with the minuend in §126, whereas our problem relates to the subtrahend. The Supreme Court was there persuaded, as we had been, [fol. 219] 176 F. 2d 152 (2 Cir. 1949), that references to convertible bonds in the legislative history precluded an interpretation excluding the portion of the purchase price paid for a conversion feature from the basis from which premium was computed. Congress responded by changing the statute almost immediately, Act of Sept. 23, 1950, c. 994, Title II, §217(a), 64 Stat. 927, 941. To be sure, as is usual, the change was prospective only; but both the action of Congress and the legislative history[8] reaffirm the purpose to limit the deductions to cases where the amortiza-

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[7] The 1956 ruling permits use of the "special" redemption price "if an actual notice of call at the 'special' redemption price on a specific or ascertainable date has been issued with respect to any particular bond or bonds, or portion thereof * * *"

[8] "Section 125 was intended primarily to deal with the case where the premium was paid because the security bore a stated rate of interest higher than that prevailing in the current market for securities of a like risk and a similar life. Equity required the allowance of a deduction against ordinary income in cases of this sort." 81st Cong., 2d Sess., Sen. Rep. No. 2375, U. S. Code Congressional Service (1950), p. 3101.

tion represented appropriate provision for prospective losses of capital that lie within the bounds of reasonable contemplation rather than, as claimed in *Korell* and here, to permit deductions where it does not.

Judgments affirmed.

[fol. 220]

IN UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Present: Hon. J. Edward Lumbard, Chief Judge, Hon. Sterry R. Waterman, Hon. Henry J. Friendly, Circuit Judges.

ESTATE OF A. GOURIELLI, deceased, THE HANOVER BANK, Executor, and HELENA GOURIELLE, surviving wife, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appeals from The Tax Court of the United States

JUDGMENT—April 13, 1961

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

[fol. 221] [File endorsement omitted]

[fol. 222]

IN UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Present: Hon. J. Edward Lumbard, Chief Judge, Hon. Sterry R. Waterman, Hon. Henry J. Friendly, Circuit Judges.

JACOB A. GOLDFARB and BERTHA L. GOLDFARB, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

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[fol. 223] [File endorsement omitted]

[fol. 224] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 225]

SUPREME COURT OF THE UNITED STATES

No. 224—October Term, 1961

THE HANOVER BANK, Executor, et al., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ORDER ALLOWING CERTIORARI—October 9, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.